S. HRG. 103–77

LEGISLATIVE PROPOSALS TO FACILITATE THE SMALL BUSINESS LOAN INCENTATIVE ACT OF 1993

ARING

ORE THE

SUBCOMMITTEE ON SECURITIES

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

ON

S. 384

To increase the availability of credit to small businesses by eliminating impediments to securitization and facilitating the development of a secondary market in small business loans, and for other purposes.

S. 422

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MARCH 4, 1993

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

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THURSDAY, MARCH 4, 1993

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON SECURITIES,
Washington, DC.

The subcommittee met at 10:06 a.m., in room SD–628 of the Dirksen Senate Office Building, Senator Christopher J. Dodd presiding.

OPENING STATEMENT OF SENATOR CHRISTOPHER J. DODD

Senator DODD. The subcommittee will come to order.

Let me welcome all of our panelists here this morning to this hearing on three bills, the Small Business Incentive Act, the Small Business Loan Securitization and Secondary Market Enhancement Act, and the Small Business Capital Enhancement Act.

These are three different measures introduced by members of this committee with one common objective or common denominator that goes through all three of them, and that is to increase the flow of capital to small businesses in this country.

In my view, this is one of the most important efforts of the Securities Subcommittee in this Congress. We simply must have, and I think all would agree, a strong and growing small business sector to create the jobs that are so desperately needed in our Nation.

The New England region, to cite my own area of the country, has been suffering the longest and deepest recession since the Great Depression of the 1930's. In Connecticut, the recession has claimed one of every eight jobs over the last 4 years. Over 200,000 people have been placed on the unemployment lines.

These jobs in the past were held by laborers, construction workers, clerical employees, mid-level managers, financial service employees, small business owners and workers, many of whom have lost not only their jobs and their businesses but their homes and their way of life.

We are facing a tragedy of historic proportions, severely deepened by the credit crunch. Sixty percent of all Connecticut businesses responding to a recent survey reported credit availability problems in their industries.

When banks do not lend, obviously businesses don't grow. Good sound businesses in my State have had to forego opportunities for expansion and job creation simply because capital was not avail-

able. Others have had to shrink their operations and lay off talented employees. And still others have gone bankrupt.

This problem has been especially severe for small businesses which traditionally have relied on bank loans for their financing needs. Ninety-eight percent of all firms in my State employ less than 100 people, 87 percent have fewer than 20 employees. These small businesses have been the primary source of economic growth and job creation not only in my own State but across this country.

I have talked with small business owners in my State who have gone to bank after bank, lending institution after lending institution, who have been turned down time after time after time. They tell me that small businesses trying to get loans in the $25,000 to $400,000 range just cannot get a dime from their lending institutions.

We simply must look for ways to help these small firms get the capital that they need to grow and prosper and to put people back to work. This is not only an issue of some concern to me, but my colleagues on both sides of the aisle here. We did a survey of the questions that have been raised by members of this committee over the last 6 weeks. And, Mr. Chairman, I would tell you that in the neighborhood of ⅔ to ¾ of all questions raised by all members of this committee regardless of the hearing and the subject matter have been related to the credit crunch and the lack of available funds for business expansion, growth, and new starts.

The Small Business Incentive Act of 1993, which I introduced with Chairman Riegle and Senator D'Amato, Senators Bryan, Kerry, Domenici, and Mack is a part of the broader effort to do just that. The bill is intended to reduce the regulatory burdens on venture capital funds, business development companies, and other financing vehicles that supplement or serve as alternatives to bank lending.

Senator D'Amato's bill, the Small Business Loan Securitization Act, which I have co-sponsored along with others, is another part of that effort. It is designed to help banks tap the public securities markets to replenish the funds they loaned to small businesses.

I know there are some practical impediments to this approach, but I think we have to explore every possible avenue to see if there are ways to bring more funds to the small business community. I also hope that at some point, the committee will give serious consideration to the Interstate Banking and Branching Act, which I introduced last month, to tackle the regional nature of the credit crunch.

I think we all have to face the reality that we've got a 1930's banking system trying to deal with the problems of the 1990's and the 21st century. Interstate branching, from my perspective, is long overdue.

These three measures, the Small Business Incentive Act, the Small Business Loan Securitization Bill, and the Interstate Branching Bill cost taxpayers absolutely nothing. There is not a dime of Federal funds involved in any of those approaches. Each of these measures is intended to lower the cost of capital, lower the cost of doing business, and ultimately lower the cost to consumers with no additional cost, no additional cost, to the American taxpayer.

Of course, there are other considerations that come into play, such as investor protection, bank safety, and soundness. Not insignificant issues. We've got to look for practical solutions to the credit crunch and we cannot be shy about asking whether our current regulatory structure may be a part of the problem.

I might add that I am particularly pleased that Senator D'Amato, the ranking Republican, of course, on the full committee has been both a leader and a partner on each of these three measures I have mentioned. In virtually every Banking Committee hearing I have attended over the past several years, the Senator from New York has raised the issue of the credit crunch, the impact on small business, and the need to take action.

The chairman of the full committee has also, on numerous occasions, most recently in hearings with Alan Greenspan and others, focused strenuously on this particular issue in trying to seek ways in which we can increase the flow of capital.

Two years ago, Chairman Greenspan specifically acknowledged that there is in fact a credit crunch. And that acknowledgment was long overdue, in my view.

I have sat on this committee, as I and my colleagues have for years, and frankly we could not even get an acknowledgement of the existence of a credit crunch. It may not seem much to many, the fact that the chairman of the Federal Reserve Board finally acknowledges that there is a credit crunch may not seem like climbing a mountain, but after 2 or 3 years of an unwillingness to recognize the issue, we welcome it.

In fact, to quote him, he says a major factor in the problems small businesses have in their ability to finance their employment and product growth is, of course, the lack of capital.

My reaction to that is, where have you been, quite frankly. Businesses in my State and across the country have been telling us that for years. We need to look to every possible means to address the problem.

The Small Business Capital Enhancement Act, which Chairman Riegle introduced on Tuesday, and which I have cosponsored as well, would authorize a modest level of Federal seed money and State funds to be used to establish loan loss reserve funds for banks making small business loans. That is a critical, critical issue. Because one of the rubs and complaints that we have from the lending institutions is their concerns about being able to maintain that loan loss reserve accounts.

And so it is a significant proposal. My hope is that we will give that prompt consideration as well.

I know that Chairman Riegle, as I said a moment ago, has a deep commitment to solving the problems that we're discussing here this morning. And of course I am well pleased that he is here, as he always is, for our subcommittee hearings. I am confident that, with his help, the Securities Subcommittee can do its job and develop a legislative package that members can support and move through the Congress.

My hope would be that we would move on this legislation as promptly as we could, Mr. Chairman. Obviously, you've got to consider all the ramifications of what we're proposing. But I can't think of anything more important that our subcommittee could do

in its contribution to these efforts than to try and ease the credit crunch for small businesses.

I obviously was delighted, as I know my colleagues were, to hear President Clinton in his State of the Union message twice refer to the credit crunch issues and their significance and importance. And again, just the other day, in speaking to a group of people, emphasized it again and it was the subject of lead stories in most of our major newspapers across the country.

So clearly the administration, this administration, has a heightened degree of sensitivity in my view about this issue. It seems to me as an opportunity for us now, at this side of Pennsylvania Avenue, to pick up that acknowledgement and try to translate it into some intelligent legislative proposals that can ease the capital flow so that businesses can grow and expand.

Again, they're the engine of our economy. It gets said so often, I'm almost tired of saying it, and almost tired of hearing it. But no one denies that without small business growth and expansion that our economy is not going to recover. In fact, it probably came as a surprise when I quoted the number of small businesses in my State. Most people think of it as the home of the major insurance companies and major defense contractors. But real economic growth in my State depends upon small businesses.

And if we don't try and ease that credit crunch and increase the flow of capital, then I am fearful that despite all of our other efforts we are not going to be able to get out of this recession.

I thank all of our witnesses for being here this morning. We've got you jammed in there like cattle here.

What I hope will happen is we'll take your testimony and then we'll have a good discussion here about this subject matter. We want to create as much informality as a committee hearing will tolerate.

So I apologize for packing you in, but you will get to know each other better this way, too.

[Laughter.]

Senator DODD. Senator D'Amato.

OPENING STATEMENT OF SENATOR ALFONSE M. D'AMATO

Senator D'AMATO. Well, Mr. Chairman, let me commend you for calling this hearing and focusing on the critical issue of getting capital to the small business community. In your statement, you alluded to the remarks made by President Clinton in his State of the Union message about the small business credit crunch. Even Alan Greenspan has conceded that there is a credit crunch. Two years ago, the Fed said there was only anecdotal information about the credit curch and that they couldn't accurately study the extent of this problem.

This is part of why I voted against Chairman Greenspan's reconfirmation, Mr. Chairman. I think I was the only person on this committee who did vote against him—and I was right then.

I would ask that my full statement be placed in the record as if read in its entirety. Mr. Chairman, you have put forth a very interesting proposal to make it easier for small businesses to access capital, including venture capital. I have also put forth legislation to open up the capital markets to small businesses.

My bill the "Small Business Loan Securitization and Secondary Market Enhancement Act," allow banks to sell small business loans to an issuer who will pool the loans, securitize them and sell the securities. We should give to the banks every opportunity to move as vigorously as they possibly can in the area of making capital available to small businesses. If we can empower them to do so by letting market forces work and without risk to the taxpayer, then, let's do it.

This idea worked successfully in 1984 when we provided for the securitization and development of a secondary market for home mortgages. We should do the same thing in the area of small businesses by making it easier for an issuer to pool their loans, securitize them, and see if the free market system will work. Today, banks are penalized for making loans—the regulators are on them and they have to set up high reserves.

If it's possible to set up a system whereby banks can sell these loans or a portion of them and be in a position to then provide further capital to more small businesses, then it should be done.

I will refer to one part of the written statement. Much like my friend Senator Dodd's State of Connecticut, when we did have job growth in New York from 1976 to 1986 where there was a million new jobs created, 70 percent of those almost million jobs came from the small business community. Today even healthy small businesses are finding that their lines of credit are being curtailed and in some cases totally eliminated.

This doesn't mean that the banks are bad—they want to make loans. Banks have to do what is prudent for them particularly in light of the new FDICIA requirements.

The person injured in all of this is the small business person. The economy also suffers because without healthy small businesses, there will be very little job growth. As we read in the newspapers constantly, larger businesses are cutting back on jobs looking to operate on the bottom line. If we don't find a way to get credit to small businesses, we're going to continue to lag in the area of job and overall economic growth.

So far, we have 35 cosponsors for this legislation. Six or seven of those cosponsors are Democrats, including Senator Dodd and a number of other members of this committee. I want to commend the chairman of the full committee, Senator Riegle, for his cooperation and spirit of bipartisanship in which we have been going forth on this legislation.

Today we are talking about doing what's best for the people. I would like to thank Chairman Dodd and the chairman of the full committee, Senator Riegle, for convening this important hearing and for moving this legislation forward quickly.

Thank you.

Senator DODD. Thank you very much, Senator D'Amato.

Senator Riegle, Mr. Chairman.

OPENING STATEMENT OF SENATOR DONALD W. RIEGLE, JR.

Senator RIEGLE. Thank you, Chairman Dodd. And let me say as well how much I appreciate your leadership on this issue and the fact we're meeting here early in the session with distinguished witnesses.

And also I would thank Senator D'Amato for his leadership. I think the spirit of bipartisanship that you speak about has been the practice of this committee now certainly over the 4 years that I've been chairman and it's the way we should work and importantly the way we will work on this issue.

I think it is a sign of the real importance of this issue that a number of proposals are coming from the Congress and from the new Clinton administration to stimulate small business capital formation. Senators Dodd, D'Amato and I, along with other Senators, have introduced the Small Business Incentive Act, which has been mentioned. This bill was developed last year by the Securities and Exchange Commission and the SEC staff has made additional suggestions since last year that are now contained in the new bill.

Among other things, the bill creates a new exemption for business and industrial development corporations, known as BIDCO's, which provide financial or managerial assistance to enterprises doing business in a State. In my home State of Michigan, we have been a particular leader in this area.

In the mid-1980's, Governor Blanchard and the legislature created the Michigan Strategic Fund to make capital and technology available to Michigan businesses. And my colleagues might be interested to know that that fund has invested over $21 million in ten private sector Michigan BIDCO's.

But then there is a leverage factor that goes to work. The BIDCO's in turn have raised additional private capital and have now invested over $34 million in 79 different Michigan small businesses.

Also on the agenda this morning is the Small Business Capital Enhancement Act and this is similar to legislation that I introduced last year with Senators Dodd and Lieberman. And this bill is also modeled in large part after Michigan's Capital Access Program.

The Capital Access Program encourages banks to make more loans to small and medium-size businesses. If a bank places a loan in the program, the bank, the borrower, and the State each pay a premium into a reserve fund. This fund protects the lender against loss on the loan.

Michigan banks have now made more than 1,800 loans to small and medium-size businesses under the program with an average loan size of $50,000. For each dollar contributed by the State to the reserve fund, Michigan banks have turned around and loaned $22 million. So you see the leverage involved. And this enables the State to stimulate substantial lending with a very modest investment and modest risk.

The bill authorizes $50 million for the Federal Government to match State contributions to such programs. The Federal Government's role is limited to approving State programs, funding the 50 percent reimbursement to the States, and confirming that the States are enforcing the agreements with participating lenders as required by the bill.

Finally, Senators Dodd and D'Amato and a number of other Senators have introduced the Small Business Loan Securitization and Secondary Market Enhancement Act. And Senator D'Amato par-

ticularly has taken the lead on this. We have met and talked about it and we are continuing to work on it together.

This bill is intended to foster the securitization of small business loans where loans are pooled and then sold to investors. And I support the concept of developing a secondary market for small business loans. And I want to commend Senator D'Amato for leadership on this particular bill.

Legislation in this area will be a very high priority for the committee and I look forward to working with all the members of the committee, Senator D'Amato on that issue, Senator Dodd on the issues that he's taken the lead on here, the regulators, and other interested parties on a bipartisan basis to develop a final legislative proposal that we can pass and move.

We obviously want to work closely with the Clinton administration as well and I intend to do so.

Finally, Mr. Chairman, the proposals to be considered this morning are, in my view, important steps in the right direction. And I would hope that the committee can pass and enact and sign into law a package of legislation designed to help small businesses raise capital. We do have an excellent panel today, including representatives of small business, venture capital, the securities industry, and securities regulators.

I particularly want to thank Gary Baker of Ann Arbor for joining us. He put his University of Michigan MBA to use as co-founder and president of Access BIDCO, providing financing to Michigan businesses. He also is a trustee of National Small business United, and vice chairman of the Small Business Association of Michigan. And I particularly welcome his comments this morning and those of our other witnesses.

Senator DODD. Thank you very much, Mr. Chairman.

Senator Murray.

OPENING STATEMENT OF SENATOR PATTY MURRAY

Senator MURRAY. Thank you, Mr. Chairman, and members of the panel. I really appreciate your holding this hearing today and giving us an opportunity to hear from you on this most critical topic.

It seems to me if we want to get our economy going again, this is exactly what we need to be looking at.

Just this week in my office I had some business people from one of our local timber towns. And as all of you know, timber is a declining natural resource in the State of Washington and the Pacific Northwest. These business people were from a manufacturing company that makes pressed board. And because of the chip supply being so dramatically reduced, they had developed a product to make pressed board out of waste paper, to use our garbage to make pressed board.

It was a very impressive project and they were well on the road. But what was inhibiting them from doing it was lack of capital for the research and development, for actually building the equipment and for its maintenance.

This is the kind of company that is the future of America. Not only will it help our timber towns that are in so much trouble, but it eliminates garbage, a costly problem for all of us.

And I just felt very frustrated talking to them because all they needed was some capital to get going. They would be providing jobs in the future. This is what our economy needs to do. And I am very excited to hear about what you have to say about this very important venture.

Thank you.

Senator DODD. Thank you very much, Senator.

Let me just say to all of you that we will have opening statements and any materials the members want to include in the record will be included.

And let me just say to our witnesses that I'm going to have this clock on here. I realize that some of you have significant statements which you'd like to make a part of the permanent record, and that will be done. So any supporting documentation and the entirety of your remarks will be included in the record.

If I could, I would like to ask you to get to your points on this so we can open it up to the discussion and question period which I think can be extremely helpful to all of us here.

So with that admonition, I say the clock is there for the purpose of guidance. Obviously, if you're in the middle of thoughts, continue with them. The clock will just give you an awareness of the time so you can try and wrap up so we don't get bogged down in too many long statements.

We are pleased this morning to have with us—and I will introduce you in the order in which you're at the table here—John Rennie, with Pacer Systems, Inc., of Billerica, Massachusetts. He is also with the National Small Business United in Washington, DC.

Gary Baker of the Baker Investment Group from Ann Arbor, MI, and formerly with Access BIDCO, is a board member of the National Small Business United.

Jeff Widen is the president of Total Foam, Inc., of Bridgeport, CT. I want to thank you. You've got an interesting story to tell and I will let you tell it to my colleagues here on the committee. It's worth noting.

David Gladstone is the president of Allied Capital Corporation in Washington. He will be testifying on behalf of the National Association of Business Development Companies and the National Association of Small Business Investment Companies.

Patricia Cloherty is the senior vice president and general partner of Patricof & Company Ventures, Inc. of New York, and is testifying on behalf of the National Venture Capital Association.

Tom Richmond, Jr., is the first vice president of McDonald & Company Securities from Cleveland, OH.

Patricia Jehle is the senior managing director of Bear, Stearns of New York, and is testifying on behalf of PSA, the Public Securities Association.

Marianne Smythe is the director of the Division of Investment Management, at the Securities and Exchange Commission. We thank you, Marianne, for being with us today.

And Barry Guthray has already been introduced by Senator D'Amato——

[Laughter.]

Senator DODD. He is the director of the Massachusetts Division of Securities. And I should almost start with you.

But I don't want to do that. I said we would go the route I introduced you in. So John, we'll begin with you at that end of the table. And again I want to thank all of you for coming and I apologize on doing it this way. It's a little tight. But believe me, we thought it worked pretty well in the past. So if you put up with us this morning, we think we can move things along pretty well.

We have an opening statement, by the way, from Senator Gramm and I know there will be others that will want to include their opening remarks and they will all be made part of the record.

John.

STATEMENT OF JOHN C. RENNIE, ON BEHALF OF NATIONAL SMALL BUSINESS UNITED, WASHINGTON, DC

Mr. RENNIE. Thank you, Mr. Chairman. I appreciate the opportunity very much to testify here today. I am testifying on behalf of National Small Business United, with 65,000 member companies around the country. And also as the chief executive of my own company, which while it's at the top end or approaching the top end of the small business sector, nevertheless I think it is instructive to point out that our company, 25 years old and relative well established and fundamentally sound, in the last year has had difficulty in raising financing both in terms of short term money and long term. And I would be happy to talk about those colorful stories as well in the discussion.

I would certainly commend you, Mr. Chairman, and the committee in taking up this very high priority policy area. We know now, and it is becoming more established every day, if we expect to see an economic recovery with job growth, then that will be dependent on a strong small business sector. And therefore, it's going to be critical that small business is able to obtain affordable short term and long term financing.

This shortage of financing has been especially acute lately due to the regulatory and economic forces that have caused the financial institutions to become even more risk-averse than they are normally. A survey done by NSBU with Arthur Andersen showed that a number of small companies had great difficulty getting loans; and those that have gotten loans, and sometimes this is lost, that those that have gotten loans in recent years or other financing have done so under somewhat adverse covenants and so forth. And certainly my company falls in that category.

I think I would like to center most of my comments on the general comments and some additional suggestions, since that, I think, is my principal role here since you have a number of technical experts that can talk specifically to the bills.

I want to point out that first of all, the community of small businesses we have in the United States is unique in the world. In fact, in western Europe, when during the 1980's when so many millions of jobs were being created here, there was a net decrease of jobs in western Europe with capitalistic type systems. And the reason for that is because they do not have the new company formations and the small business growth that we have in the United States. So in a way, even though we may find ourselves battling with eco-

nomic blocs in the future, the one thing that we have that the other two blocs don't have is a real vital small business sector.

And so it is absolutely a competitive advantage right now. I think it is something we must preserve in the future.

The very size, however, and diversity of the small business community makes it difficult for policymakers. There's a tendency, although I am happy to see recently that business is not being considered monolithic, but there is a tendency to try to treat all businesses the same. And of course, we are not all the same. And even within the small business community, we are not the same.

In my testimony I point out that while we may have 20 million or so small businesses in the country, 15 million are essentially proprietorships, very small companies of that nature, unincorporated companies. And the other five million are the ones that have at least one full- time employee.

Now, the ones that are in the 15 million sector have one set of problems. They are a very dynamic sector. They are basically, you know, individuals who are working and need micro loans and operate from their own capital in many instances.

When you get to the second group, which my company is a part of, the five million, they break into two important types. One type is what I have characterized as the lifestyle companies. These are companies where the owners get financial pay back from ongoing cashflow from the company. Either of these are perfectly legitimate; they are just different strategies for financial payback.

The other part of the five million that have the employees—at least one employee and they build up to 500 employees in the sector, are the growth companies. And that growth even is varied from one company to another. There's the explosive growth, technological type companies, if you will. And then you have less high growth, but nevertheless growth-type companies inferring need for periodic infusions of money in addition to their operating capital.

The whole point of bringing this up is because it is important to understand that when you are addressing the small business community in terms of financing, you're looking at a mosaic. You're not looking at one silver bullet. You're not looking at just one type of financing that is important.

So as a result, I have suggested in here that your—the acts, the two acts that we primarily focused on and then Chairman Riegle's act which we read I think yesterday address these things. In the sense they are hitting various aspects of the mosaic, and we think that's very, very important, not only in and of themselves, but in fact that they recognize that there are different kinds of financings that are required by different kinds of companies. And that is very important.

We had suggested—I have suggested a few new things or additional things for the committee to consider. One is the long-term financing of lifestyle type companies. Some years ago in the early 1980's we proposed a new instrument called the Small Business Participating Debenture. This was essentially a long term loan in terms of the lender, but in terms of the creditor, it had characteristics that were more like an investment, so it was more attractive from that viewpoint. We think another look at something like that

may be worthwhile. I also have suggested an enhancement of the 7–A loan program within the SBA.

Also I would like to mention a couple of things just quickly having to do with overseas finance.

Senator DODD. Since you mentioned the 7–A, let me just address that. I have raised that issue as well.

I was stunned to find out, despite the efforts to get the fund, and to get the monies up, how few lending institutions wanted to be a part of the 7–A program.

Mr. RENNIE. Well, that's part of the problem, as I mentioned. There in Massachusetts, for example, the Danvers Bank, which is a $240 million bank, made more small business loans last year than any bank in Massachusetts.

Now when you look at the large money center banks, they're just not participating. And that's—we need to get those big money center banks into the action.

The two areas that I would just quickly point out in the foreign area, I would recommend that the committee investigate and perhaps hold hearings on how to talk about the availability, the cost, and the linking of affordable off-shore financing to the small business community of the country. Because I have found so far that off-shore financing right now is much more competitive in most of the areas that I deal with than with United States, especially long term financing.

And second, I think if we are talking about Government help in terms of small business in the international area, I think we need to work in the areas of how to support the guarantees or whatever in the areas of standby letters of credit and bonding.

Many times, in operating capital, the company may be able to sustain itself. But if you get real good reaction in overseas markets that may require standby letters of credit and so forth, that's where you begin to use up your credit very rapidly. So I just bring those two to your attention.

Thank you, Mr. Chairman.

Senator DODD. Thank you very much. Those are good suggestions.

Mr. Baker, thank you for coming.

STATEMENT OF GARY BAKER, BAKER INVESTMENT GROUP OF ANN ARBOR, MI

Mr. BAKER. Mr. Chairman, members of the subcommittee, good morning. My name is Gary Baker. I am founder and president of Baker Investment Group, a small business and real estate investment firm in Ann Arbor, MI.

Among other activities, I was co-founder and president of Access BIDCO until last year when I left to form Captec BIDCO, which is in the process of being formed.

I am a member of the Board of Trustees of the National Small Business United, which is the oldest trade association exclusively representing small business in the country.

Thank you for the opportunity to address you on the problems of access to credit, which is debt, and access to capital, which is equity.

The Small Business Incentive Act of 1993 seems to be a step in the right direction. And for this we should all thank you. This act is fairly technical and in the interest of time, I shall confine my testimony to section 204, which would automatically exempt BIDCO's from regulation under the Investment Company Act of 1940 under certain conditions, thereby reducing the need to obtain an individual exemption on a case-by-case basis.

An understanding of BIDCO's would be helpful in considering the ramifications of this section. BIDCO's are a new type of financial institution. They are designed to provide access to debt and/or equity capital for the small and medium size companies. BIDCO's fill the gap between typical low-risk, low-return commercial bank lending and high-risk, high-return venture capital investing. It is the middle-risk, middle-return market that we're talking about.

In the case of Michigan BIDCO's, they are Michigan corporations licensed pursuant to the Michigan BIDCO act. They are private for-profit corporations that are licenced and regulated by the Michigan Financial Institutions Bureau, which is the same agency that regulates State chartered banks, savings and loan associations, and credit unions.

BIDCO's are subject to examination at any time by the commissioner of the Financial Institutions Bureau. Such examination is required at least annually.

The regulatory system administered by the Financial Institutions Bureau is designed to prevent fraud, conflicts of interest, and mismanagement and to promote competent management, accurate recordkeeping, and appropriate communication with stockholders.

Now, being subject to the regulatory and enforcement provisions of the act, provide the comfort to prospective shareholders as to facilitate equity investment in BIDCO's, and to prospective debt sources to facilitate borrowing of money by the BIDCO's, and in general to safeguard the reputation of BIDCO's as a type of financial institution.

This very careful regulation and supervision of BIDCO's could and should supersede the protective intent of the Investment Company Act of 1940. There are, however, three restrictions on this automatic exemption as stated in section 204 that I would like you to reexamine.

First, section 204 states that BIDCO's will automatically be exempt if they propose to do business primarily in that State. I think this should be left up to the State that regulates the BIDCO's. While it is true that most if not all BIDCO's currently operate within the State in which they were formed, this may not always be the case.

As specialization creeps into the financing industry, at the same time, State boundaries fade as a realistic barrier to trade, it is very conceivable that specialty BIDCO's will be formed around certain industries where there is common knowledge and understanding. This is certainly true for the venture capital industry.

If a BIDCO can conduct its affairs in such a manner as to make the State regulatory agency comfortable with its market niche approach and gain approval to loan money to businesses outside the State, what additional benefit would this proposed law hope to obtain?

Second, section 204 states BIDCO's will automatically be exempt if at least 80 percent of each class of securities being offered must be held by persons who reside or who have substantial business presence in the State where the BIDCO is regulated.

While this probably happens anyway, this requirement may not be necessary as long as all blue sky laws and other security regulations are complied with in each State in which the securities are being offered. Which is what happens currently.

Again, the State regulatory agency is very thorough. Because it has not only initial but an ongoing regulatory responsibility, they're going to look at this very carefully.

This is a good bill, but it could be much better with a few changes. Those changes are small, but could be important to certain BIDCO's trying to form without going through the months of waiting and unnecessary regulatory red tape at the Federal level just to gain an individual exemption anyway.

The Small Business Loan and Securitization Secondary Market Enhancement Act of 1993 is patterned after the Secondary Mortgage Market Enhancement Act of 1984, which was tremendously successful at increasing funds available for residential mortgages. However, there are some important differences between the mortgages on residential real estate and small business loans.

First, mortgages that are sold on the secondary market are formula-driven. Standardization is the key here. That is, they have characteristics similar enough to conform to certain fairly specific requirements that allow them to be pooled with other mortgages and securitized.

Many small businesses need access to credit that fall outside this strict formula that would be necessary to sell the loan. This would necessitate the banker writing two loans, one that could be pooled and securitized on the secondary market that would have less risk, and one that would be held by the bank that would have greater risk. This could mean that there would be less collateral for the second loan, because it is needed to support the first loan. Also, the second loan would probably be subordinate to the first loan.

Currently, the banker writes one loan with a blended risk profile. Under the proposed legislation, the banker would carry a smaller subordinate loan with higher risk or the banker would decline to make the second loan altogether, thereby reducing the access to credit for small business customers.

Neither position is good public policy. However, a BIDCO loan which is always subordinate to the bank loan could be substituted for the second bank loan without exposure to depository funds.

The most important consideration should be given to include more than just traditional commercial banks as originators of loans. Just as the mortgage companies can originate residential mortgages, amend this act to include other regulated nonbank small business lenders as originators of small business loans. The SBA allows for regulated nonbank lenders in its guaranteed loan program with great success. It's not the large banks that make the majority of small business loans; it's the small banks and it's the regulated nonbank lenders.

As in the residential mortgage market and the SBA loan guarantee program, this could actually increase the funds available for

small business loans and increase competition in certain areas, as in the case of New England, for small business loan customers.

This is a good bill. Again, with a few minor changes, it could be a great bill.

Senator DODD. Say it again.

[Laughter.]

Mr. BAKER. In conclusion, I hope you found this testimony valuable. I have many other points which are in my written testimony. I look forward to an opportunity to discuss this with you further.

Senator DODD. Those are good suggestions, and we are looking at them. I am intrigued, particularly with the first point that you make regarding within the States. Obviously, someone who is a strong advocate of interstate banking and appreciates the importance of trade between States and business between States ought to take a look at that. I appreciate it very much.

Mr. Widen, we appreciate you being here.

STATEMENT OF JEFFREY C. WIDEN, PRESIDENT OF TOTAL FOAM, INC., OF BRIDGEPORT, CT

Mr. WIDEN. That's quite all right. Thank you.

Good morning. My name is Jeffrey Widen and I am the president and founder of a small business. And we are based in Bridgeport, CT, in Senator Dodd's home State. It is known as Total Foam.

Prior to Total Foam, I had started two other companies in the foam packaging industry. And in both cases we were quite successful with the business, but quite unsuccessful with our long term financing.

I had to sell one business because I lacked the financing to expand. In both cases, they are quite successful today, unfortunately. One has sales of $100 million, and the other doing very, very well unfortunately has had to move out of the State and it has taken 135 jobs with it.

With Total Foam we have patented a unique foam packaging system that's ideally suited for packaging anything from electronics, computers, to glassware. I started Total Foam in 1987, invested approximately $450,000 of my own money, and of course long hours and a standard quotient of blood, sweat, and tears went with it.

During my first year, year and a half with Total Foam, I explored every avenue of financing, banks, venture capital groups, whomever. Searched high and low for financing. And even with an excellent track record that I had, especially for the new business startup, I really didn't have any success at all in the northeast. And an initial call to a bank or a phone call was probably the extent of my involvement and usually they didn't return my phone calls.

After about a year and a half, I spent most of my personal funds on getting the product going, engineering, development, field evaluations. And quite honestly, I was getting very concerned about the company's future.

In late 1988, fortunately, I was introduced to Allied Capital Corporation. That's a business development group located here in Washington, DC. And with the support of Mr. David Gladstone, who is with us here today, we were able to raise the financing to really get the company going and get it off the ground. We were

able to finish the product development and get the marketing going. And to date they have invested a little more than $2 million in Total Foam.

We have continued to make the rounds of Connecticut banks. And at last count, we have probably talked to about a dozen or so about a business loan, and we have had absolutely no success. We stated we are willing to do the paperwork for an SBA loan, and of course that's guaranteed, 90 percent of it is guaranteed by the full faith and credit of the U.S. Government, as we all know. But the banks basically discouraged us from the paperwork and the involvement.

At this point in time as I sit here, we still have no line of credit. And basically, although sales are increasing every month, we had $160,000 in sales last month, we're on track to achieve $50 million in 5 years, but we are going to need financing to do that.

My situation may be somewhat unique with my background and whatever, but I can tell you that when I talk to other entrepreneurs and small businessmen in Connecticut, they say the same thing. And they say, basically, indeed banks are not making loans to small businesses.

I am sure somewhere a small business is getting a bank loan as we speak. And I imagine there are some banks that are actively pursuing this marketplace. There, however, is an excruciating shortage of financing available in Connecticut which Chairman Dodd has pointed out. And I am in Bridgeport, and that situation is even worse in Bridgeport. There is very little money available for the small businessman.

It is really a shame, too, because from what everybody knows and hears it's the small businessman that's creating jobs. And we employ about 25 people at the time. We have actually been marketing about 1 year now. And we are growing all the time. Everyone says it's important to create these jobs for our national economy, but we need the financing to do so.

About 50 percent of all the U.S. workers are employed by small businesses. And the curious thing is that there seems to be money for corporate takeovers where jobs and businesses are jeopardized but there is very little money available for the small businessman who is creating these jobs.

I am sure banks are much less comfortable in ascertaining the worth of a small business as compared to loaning money for a car or a condominium development. But there has got to be some financing available somewhere.

The Small Business Investment Act—Incentive Act, excuse me—and the Secondary Market Enhancement Act may be just what the banker needs. It reduces his risks, of course, because he can pool these loans and hopefully sell them to an investor.

You know that the banker does get nervous in trying to evaluate something that he can't look up in a blue book or repossess. I hope there are no bankers here.

I don't know exactly what I can say to your committee, Senator Dodd, to emphasize the small business crisis. But I do believe that the proposed legislation will help.

I don't know exactly how you're going to make the banks be more aggressive, but I do know one thing, and I want to point this out.

That without somebody like an Allied Capital, Total Foam wouldn't be in existence today; we wouldn't have the jobs.

I believe in Allied Capital. Obviously they have been very good to us. And I believe in the business development company concept. These type companies seem much more at ease with the small business and what we're trying to do. And if these development companies could be stimulated to create more loans, this might be the answer you're looking for.

Also, if more of these business development companies could be created, this would also be helpful for the small businesses and for the U.S. economy in general.

Senator Dodd, I hope your committee will lend a sympathetic ear to the small businessman and to legislation that would encourage business development companies to continue to develop and prosper. And certainly I do appreciate the opportunity of being here with you this morning and hopefully you will lend a sympathetic ear to the small business.

Senator DODD. Why do you not take a couple of minutes and explain the concept of Total Foam.

Mr. WIDEN. Any opportunity to promote the company. I hope this is on TV.

[Laughter.]

It is shooting liquid urethane foam around a product to protect computers, glassware, things like that that are quite heavy but very fragile. What happens is, it expands 200 times as it rises around the product, so there is very little storage and very little material handling involved. It basically injects liquid urethane. Within 40 seconds, it is turned into basically a urethane packaging foam which is a flexible urethane.

We were able to patent it. The other two companies I mentioned before also started sort of in the same industry, but what is exciting about this company is that we are able to do it very inexpensively. The equipment used to be $7,000, $8,000 cost to me before I could get it in the field. Now I can produce the same kind of product for $200 to $300. We have been able to eliminate the heat, the pressure, all of the problems environmentally that we had before and we can still produce a product that anybody, from a small mailbox shipping situation to UPS, to—Well, Sikorsky. We just got all the Sikorsky business in Bridgeport.

Senator DODD. And that is as opposed to the beads, etc.

Mr. WIDEN. Yes. It is the same idea. It actually provides a better packaging media. You do not have the beads flying all over the place, and whatever.

Senator DODD. I want to come back to you and talk about that 7–A program in a minute, because I am very upset about it. We fought like hell around here to get the additional funding for the 7–A program, and I was stunned. You are right. Ninety percent? This is not a risk for a lending institution. They are just not doing it. We hear, and I am very sympathetic, and I think Senator D'Amato is probably also sensitive to the bankers who complain about the regulators coming in in a very heavy-handed way and discouraging the credit window from being open. But that argument falls a little bit if your fine institution is unwilling to get involved in a program that really has almost no risk at all to the

lending institution. I want to be sympathetic to them, but I am not as sympathetic when I hear about their unwillingness to involve themselves in a program that we have fought very hard to get the additional funding for and that they are not taking advantage of. I will come back to you in a minute on that.

Mr. Gladstone, you have already been at least partially introduced by Mr. Widen, so thank you for being here.

STATEMENT OF DAVID GLADSTONE, PRESIDENT, ALLIED CAPITAL CORPORATION, WASHINGTON, DC; TESTIFYING ON BEHALF OF NATIONAL ASSOCIATION OF BUSINESS DEVELOPMENT COMPANIES AND NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES

Mr. GLADSTONE. Senator Dodd, thank you for inviting me back again.

You asked for some comments on the current credit crunch, and I have one of my epistles, as you referred to it before, and that will be read into the record, hopefully.

What I would like to do now is just summarize some of the points that are in that, and tell you what my perception of what the credit crunch is all about.

I was lending money to small business back in 1974 and 1975, as well as the 1981–1982 crisis, and I can tell you that the crisis today is much more deep and wide than it ever was back then.

We are having a terrible time getting portfolio companies such as Jeff Widen's money to grow their companies.

Primarily, as you know, the banks are the only people around that have a lot of money available for small businesses, and there are two things that are killing the bank lending business: One being regulation, which has been talked about; and the other is litigation, which has not been talked about.

In the first instance, the regulation I can cite some only because I sit on the Bank Board here in town, that the OCC regulations have become so strong that it makes it very difficult for a small business lender to loan money to small business.

If you have to have a regulation that has you doing an appraisal of a real estate every year because that is part of the collateral, it is going to cost you $3000 to make a $50,000 loan just to get the appraisal every year, so not many people are going to go into that business.

If they do not do the appraisal, they get written up by regulators and no loan officer in his right mind is going to jeopardize his job in this environment by going out and doing something that is going to be written up by the regulators.

Most of the small business lenders are done on a character basis, not so much on collateral. The OCC regulators constantly harp on the fact that small business loans are being made on the basis of character. I would suggest that those are the best way to make loans.

Finally, I would like to mention that litigation is also destroying some of this bank lending. You have today an environment in which most bank lending officers who have been lending money for the 1980's have been involved in multiple suits.

This is where the small business person, or the business involved turns around and sues the bank rather than paying back the money. They have nothing to lose. If you know, the system today provides that a plaintiff can file a suit and claim anything they want to, frivolous or not, and tie up a bank for years and in essence extort money from them in order to go away.

Senator DODD. Are you talking about product liability suits?

Mr. GLADSTONE. No. I'm talking about a small business, or big business that borrows money from a bank and then cannot pay them back. But, rather than deeding over the property, or walking away from it, they generally sue the bank over some frivolous item such as "you promised," or "you said you were going to do this."

The whole marketplace is rife with these kind of suits. They're called "strike suits." They are typically taken on a contingency by the law firms, and they are looking for any way they can to raise a couple hundred thousand dollars to several million dollars against the bank in order to go away from a situation that is a troublesome one for the bank and for the small business.

The only way to stop that is to have commercial suits that involve a situation whereby the plaintiff, if they lose, have to pay the legal costs of the defendant. We are the only civilized Nation that I know of that is involved in a situation whereby the plaintiff can bring a suit, cause all kind of destructive problems for the bank, and then walk away from it and have nothing to say afterwards other than thank you very much.

Senator DODD. You may be aware, but Senator Domenici and I are working on a package that we hope to be able to introduce at some point that involves strike suits like this and others.

I have let you know about some of the product liability issues which is another legitimate area, but there is a whole body of reforms that I think are needed in this area and you just identified one of them.

We are working on some legislative proposals.

Mr. GLADSTONE. I think every loan officer is going through some kind of shellshock right now from all the lawsuits and testimony that they are involved in.

More specifically, I would like to comment that section 207 of the Act that requires that BDC make available managerial assistance in all situations, should be relaxed as the bill calls for simply because there are some very small businesses that you do not need to help.

For example, in Jeff Widen's case we are very willing and able to go help him, but there are muffler shops and small dry cleaners who do not need managerial assistance. In order to get those people money, you need to relax that provision.

In addition, at section 208 there is no reason not to be able to buy loans from banks, or the RTC, or the FDIC—currently BDC's are prohibited from doing that—and we think the law is adequately drafted and will help us with that, and we appreciate that relief.

There is only one criticism of the law. That is the fact that the "small business" as defined by the law is quite small. It also favors those businesses that are service-oriented rather than manufacturing-oriented. That is, it states that the net worth of less than $2 million, and assets of less than $4 million, is very, very small.

We would encourage you to change the bill to adopt as a "small business" definition the definition used by SBA, and let SBA be the arbiter of the small business. That is contained in my written testimony, and I would encourage you to do that.

As far as the rest of the bill, we are very happy to see that this bill has a provision to allow BDC's to be leveraged. That was not in the prior bill, as you remember. We lobbied hard for that change, and we are very thankful that leverage is in the new bill.

We also want to tell you that sections 201, 202, 203, and 205 are extremely good. You will encourage small business investment company formation with those provisions, and we think there will be a renaissance when combined with the new SBA legislation.

So we are applauding you, and with only minor changes we stand ready to help you get it passed through both the House and the Senate and on to the President's desk.

Senator DODD. Those are good suggestions, too.

I must say in looking at the "small business" definition, just on the economic package that is in front of us, the short-term stimulus package has some investment tax credits that they are making permanent.

I have heard from some of my people in Connecticut about whether or not the definition of a small business included in there is too small to really benefit from the investment tax credit approach. When you raised that particular point it made me think of that.

Thank you very much for your testimony.

Ms. Cloherty? Did I pronounce that correctly with a good Gallic pronunciation?

Ms. CLOHERTY.: You sound Irish.

[Laughter.]

Ms. CLOHERTY.: You are the only one who ever pronounced it correctly.

[Laughter.]

STATEMENT OF PATRICIA M. CLOHERTY, SENIOR VICE PRESIDENT AND GENERAL PARTNER, PATRICOF & CO. VENTURES, INC., NEW YORK, NY; TESTIFYING ON BEHALF OF NATIONAL VENTURE CAPITAL ASSOCIATION

Ms. CLOHERTY.: Thank you, Mr. Chairman, members of the committee. I am pleased to be here to participate in this roundtable on financing entrepreneurial small business.

As background to the discussion right now, I will simply introduce myself a bit more and describe my firm, since what "venture capitalists" do is really quite mysterious to normal people.

I am General Partner of Patricof & Co., where I was a founding member of the firm 23 years ago. I also served 2 years, the first 2 years of the Carter administration, as Deputy Administrator of the Small Business Administration, and subsequently co-founded a small manufacturing company in New Jersey which grew like a weed, and I am pleased to report was financed principally from customer advances.

By the end of the second year, we did $18 million in volume and netted $4.5 million after full taxes, and had 200 employees. So I sold it to 3–M.

[Laughter.]

Senator DODD. Mr. Widen would like to talk to you.

[Laughter.]

Ms. CLOHERTY. I know that.

Today I am representing the National Venture Capital Association, of which I am a director, and I would also like to point out that 2 years ago I was appointed chairman of the Investment Advisory Council that worked to revamp the Small Business Investment Company Program for SBA that David Gladstone had mentioned.

I brought a copy of that legislation with me today. The regulations are in process at the moment, and I think it dovetails with the subject of your discussion very nicely.

I have had many years in the trenches of entrepreneurial business and the truth is, I describe myself as a Peace Corps Volunteer turned capitalist pig.

[Laughter.]

Ms. CLOHERTY. As one of the early volunteers, I was in Brazil——

Senator DODD. They just say "I'm a Peace Corps volunteer turned pig."

[Laughter.]

Ms. CLOHERTY. Well, I was in agricultural extension; what do you want?

[Laughter.]

Ms. CLOHERTY.: I was in Brazil in the early 1960's, but I decided at that very moment that people simply do better being able to make their own money than being on the dole, and there is no better route for doing so than the entrepreneurial one, when all you start with is brains and energy but no money.

Now, my firm. We are a diversified venture capital partnership. We started in 1969 with $2.5 million under management, and we have grown that to $1.5 billion under management in the United States and Europe. Two-thirds of that is in Europe, and one-third is here.

We were capitalized at the outset by wealthy individuals. After the 1979 ERISA, changes in the ERISA legislation, we began to raise money, as we do every 5 years, from institutions—mainly pension funds.

Our niche as venture capitalists is in financing at the equity level, not debt. Debt is the long-term permanent capital that underlies the operation of any business, without which there is no credit even when it is available. It is that portion of the balance sheet that is obliterated when banks get cranky.

We seek higher-than-average returns from taking equity positions in hopefully rapidly growing companies. Our returns are derived in the main from long-term capital gains with interim illiquidity—almost pure illiquidity in the interim, so we get no interim interest payments and dividends because growing companies consume capital; they do not pay it out.

Our niche of the small business world, so to speak, is that potentially very-high-growth portion of the total universe, and we spend every day all day looking for those situations and working with them.

We have invested in virtually every State of the Union over 23 years. Our portfolio is diversified with respect of industries, stage of company, size of investment, and geography.

Some of our current investments, to give an example, include a company called Tesaver Corporation in Elmsford, NY. It was a pure startup 2 years ago. We seeded it with $300,000.

They are two former IBM'ers—and I will say, parenthetically, there are many more ex-IBM'ers today—we seeded them with the $300,000. Then, as they got their patent applications filed and the prototypes built, we put in an additional $2 million, brought in other partners, and the company we expect to sell its first product for a test basis this year.

Another company is not a startup; it is a buy-out. We put $10 million of a total $39 million equity financing to back a fresh management team in a company called Sunglass Hut headquartered in Florida. They are an eyewear retailer. Since our investment was made 18 months ago, the company has doubled in size.

Shipnet Systems is an Illinois-based logistical information service that was a restart. That was something another firm had put about $14 million. I put $3 million in to give it a restart 2 years ago. It is the kind of business that links shippers of goods with their customers so they know what is coming and when. It is part of "Just In Time." I expect it to be a fabulous success. It is my investment.

[Laughter.]

Ms. CLOHERTY. Creative Biomolecules, Hopkinton, Massachusetts, is a biotech company. We have large investments in biotech. They are extremely promising for the best technology in the world. It is truly impressive. I just hope that some of our companies have products before I die.

[Laughter.]

Ms. CLOHERTY. Now backing growing companies requires capital, and that is the subject of this conversation. They require, most importantly, equity that comes from savings, family and friends, Angels, doctors, dentists, venture capitalists, banks, and other nonbank lenders, and the public securities market's debt and equity. That is normally the pattern.

Today, usually the higher the rate of growth, the more capital required. Today's national imperative is in fact economic growth. Policies that free up private capital, that elicit the best of entrepreneurial energy in the country toward growth are not accidental. Those policies are developed. They are maintained. They are optimized.

NVCA supports policies in every aspect of the legal and regulatory structure that will free up such energies and permit capital to flow.

Many aspects of the three proposed laws we are looking at today seek to do just that through a series of new proposals and technical amendments.

NVCA has submitted detailed comments on those. We support it in the main, and we have made some modest suggestions for modification. They are very, very slight.

We also took time in our statement to address a couple of other areas that bear importantly on flows of risk capital.

We took a stand in support of a reduction in the rate of capital gains' tax which does not directly affect our industry, but indirectly it affects it powerfully by its effects on individuals who have money to put at risk.

Second, we took a position against the proposed accounting treatment of employee stock options which is the currency of our business. Entrepreneurs do not get paid a lot of current compensation. They get options. They have some stock. And they hope that if they really knock themselves out they can make it worth something in the future.

So the propose charge to earnings of the options, when issued, is precisely what entrepreneurial business does not need, and we oppose it powerfully. The earning——

Senator DODD. I agree with you, by the way.

Ms. CLOHERTY.: Thank you, very much. So much of the negative effects of that policy on small business is an inadvertent consequence of legislation that is proposed for another purpose, and small businesses get whipsawed in that wake.

The irony today is that two-thirds of the world economies are seeking to find decent models for economic democracy rooted in entrepreneurship. The United States theoretically is closer.

I believe it is our view that in a philosophical way we need to re-legitimize the art of making money in response to taking high risk, and reflect that premise in all relevant policy.

Thank you.

Senator DODD. Thank you, very much. We appreciate it. I love your calling a bank "cranky."

[Laughter.]

Senator DODD. I have heard it described a lot of different ways over the years, but "cranky" may be the best one I have heard.

Mr. Richmond, thank you for being here.

STATEMENT OF THOMAS N. RICHMOND, JR., FIRST VICE PRESIDENT, McDONALD & CO. SECURITIES, INC., CLEVELAND, OH

Mr. RICHMOND. Thank you, Chairman Dodd, Senator D'Amato, Senator Murray.

I appreciate this opportunity to testify on behalf of McDonald & Company Securities, Inc., this morning regarding the access to capital for small businesses in America today. McDonald is itself a smaller business employing roughly 900 people.

While we are a full-service brokerage house, our strength since our founding some 70 years ago has been the relationships we have maintained with the smaller businesses generally located within a 500-mile radius of our headquarters in Cleveland.

I have been an investment banker for 8 years, and I currently specialize in the structuring, pricing, marketing, and trading of public and private debt and equity securities generally backed by the assets of smaller partnerships and corporations.

Prior to joining McDonald, I was involved in many aspects of the primary and secondary mortgage-backed security and collateralized mortgage obligation, or CMO markets at Paine Webber and Salomon Brothers in New York.

The subcommittee has asked me to comment on two of the specific legislative proposals to facilitate finding capital for small businesses.

The first, S. 479, the Small Business Incentive Act of 1993; and the second, S. 384, the Small Business Loan Securitization and Secondary Market Enhancement Act. I endorse them both and believe they will both be helpful to small business without jeopardizing investor protections.

The Small Business Incentive Act introduced by the Chairman will make many useful improvements to the Federal securities laws. It would raise the ceiling on exempt stock offerings in section 3(b) of the Securities Act from $5 million to $10 million. Congress has not altered this ceiling since 1980 and should do so to keep pace with inflation.

President Roosevelt signed the Securities Act into law on May 27, 1933. Enacting this change would be a fitting way to commemorate the Act's 60th anniversary.

This legislation also would grant certain exemptions from the Investment Company Act of 1940 to improve the ability of investors to pool funds and invest in small businesses.

Current exemptive provisions are too cumbersome or restrictive for effective use. This bill would mitigate these difficulties, such as reducing the restrictions on business development companies and allowing the creation of exempt private investment companies. While these exemptions will not solve every problem, they would be a step in the right direction.

The Small Business Loan Securitization and Secondary Market Enhancement Act introduced by the Ranking Republican Member, Senator D'Amato, would facilitate the securitization of small business loans.

The bill builds on the successes of the Secondary Mortgage Market Enhancement Act of 1984, or SMMEA, and would permit private poolers of small business loans to securitize these assets and sell them to a broad class of investors. While there are significant differences between small business loans and mortgages, this legislation would be extremely useful.

Enlarging the universe of potential end-investors would encourage lenders to make more loans to small businesses, increasing the flow of funds to these companies. It would also provide new, potentially exciting investment opportunities to the public. It especially would permit more types of institutions to purchase securitized small business loans.

Given today's interest rate environment and the fact that many portfolios are looking to enhance their yield, the time for such a package may be fortuitous. I support this legislation enthusiastically.

I understand that this subcommittee is also grappling with the question of whether the public is better served by the private pooler approach of S. 384, or whether the House approach of a GSE such as VELDASUE is preferable.

I believe that the best initial solution is to allow the private sector, using the provisions of S. 384, to develop the market for small business securities. A GSE could potentially open a taxpayer to

considerable liability, and would probably crowd out most private poolers.

The private sector could move more quickly, I believe, work through all the problems inherent in the creation of the market, and put creative problem-solving structures into use.

If Congress determines after review and analysis that today's problems are not being properly addressed, it could act as a future time as it sees fit.

If the Congress is looking for a way to bridge the gap between the Senate's approach and that put forth by the House, one possibility might be to create an indemnity fund that only protects pools of these securities against catastrophic loss.

Pools insured by a prudent, statistically derived combination of subordination, reserve funds, and insurance policies might prove attractive to potential investors in both senior and subordinated securities of this type.

Reserves could be prefunded by holding back proceeds to borrowers, or funded on an ongoing basis by the capture of the spread between each borrower's loan rate and the eventual rate on a pool. Insurance coverage could be provided by private bond insurance companies, or on a limited basis some Government-created insurer.

I appreciate that the difficulties of creating such a system might be formidable, but it is one potential way to chart a middle course on Government backing. I would like to stress that any positive outcome to these issues will require the close cooperation of regulators, structurers, and perhaps most importantly investors.

Any attempts to create a viable market large enough to solve the capital crisis that exists today will depend almost entirely on the ability of the investment banking community to sell whatever securities emerge from the process, especially subordinated pieces of these packages.

Once again, I support these bills that the Chairman of the subcommittee and the Ranking Member of the full committee have introduced, and I appreciate the opportunity to testify and would be pleased to answer any questions.

Senator DODD. Thank you, very much.

Ms. Jehle?

STATEMENT OF PATRICIA JEHLE, SENIOR MANAGING DIRECTOR, BEAR, STEARNS, NEW YORK, NY; TESTIFYING ON BEHALF OF PUBLIC SECURITIES ASSOCIATION

Ms. JEHLE. Chairman Dodd, Senators. My name is Pat Jehle. I am pleased to be here today to discuss an issue of critical importance to the continued economic recovery of the Nation, the availability of small business credit.

I am here not only in my capacity as Senior Managing Director at the Securities firm of Bear, Stearns in New York, but also on behalf of the PSA, of which my firm is a member.

The PSA is an international trade organization of securities firms and banks that underwrite and trade mortgage and asset-backed securities, U.S. Government and agency securities, municipal securities, and money market instruments. PSA's membership includes all major dealers in mortgage- and asset-backed securities.

On behalf of PSA, I would like to thank Chairman Dodd and Senator D'Amato for inviting me and asking me to speak on this issue.

My professional background, as well as the interests of the PSA, is in asset securitization. I run the asset securitization group at Bear, Stearns.

I would like to confine my comments to issues surrounding the securitization of small business loans, and focus on the issue of credit risk. My written statement discusses the issue of small business credit securitization more fully.

The problem of credit availability for small businesses has received much attention. There have been a number of statutory changes designed to increase bank lending to the small enterprises.

Because developments in the secondary markets for home mortgages has successfully expanded the availability of credit in that market, and because the capital markets have demonstrated ingenuity in securitizing of all types of financial assets, many of today's small business proposals involve provisions to encourage the securitization of small business loans. Presumably this would attract new sources of capital to the small business lending market and would result in greater volume of small business loans at lower rates.

S. 384 is designed to remove the statutory and regulatory roadblocks to a viable market for securitized small business loans, and I think it does it very well.

One of the problems immediately apparent in attempting to create a securitized market for small business loans akin to that for the mortgage market is that the nature of small business lending is quite different than that of the mortgage business, and the relationship between the banks and their clients is quite different.

Unlike a mortgage which has a finite maturity and scheduled payments, small businesses shopping for credit have ongoing financing needs that can't be satisfied with a single type of loan, or maybe even a single format.

Senator DODD. Do you agree with Ms. Cloherty's statement earlier that the higher the rate of growth, the greater the need for capital?

Ms. JEHLE. I believe that is true. Yes, I do. One of the earlier speakers, though, had suggested that the lack of homogeneity might be a sort of fatal flaw. There has been diversity of loans underlying the RTC's securitizations and some of the consumer receivable securitizations. I think with today's computer technology and cash flow analysis you can take a lot of different types of loans and create a synthetic security out of them.

I would hate to see the borrower/client relationship change, though. The bank should be able to continue to work with its customer, to work with its ongoing financing needs, both to help the customer expand his business, as well as to prevent an unnecessary delinquency or charge-off.

Some of the structures that have been used in the marketplace so far are rigid from a tax standpoint and would prohibit a bank from continuing to work with the customer and continuing to manage the loan, because theoretically the loan was sold so the bank shouldn't be managing it. I think the tax section of S. 384 address-

es that quite well by extending REMIC-like treatment to small business loan securitization. I think we need flexibility in that section of the Act.

I also think the most important part of the Act is that it creates a very liquid secondary market for these loans which obviously is a desirable element.

The banks' major objective in securitization obviously is to remove the assets from their balance sheet and increase the ratio of capital to assets. Whether this is possible depends on what the regulation is concerning retention of those assets or whether it is considered a sale even if the bank still retains a minor amount of recourse or subordinated participation in the loan.

The on-balance-sheet funding for small business loans that require 100 percent risk-weighted capital is a very costly way for banks to fund these small business loans.

Under the current Call Report instructions for commercial banks, any transfer with retention of risk would result in no transfer at all for capital purposes.

It is my opinion that the capital markets would require some retention of credit risk by the issuing bank; and, that if they could not remove the loan from their balance sheets because of that retention of risk, I think the development of this market would be impaired.

I think the Federal regulators are rightly concerned that the banks hold capital against risk. However, S. 384 requires only that amount of capital necessary to compensate for the estimated liability under the recourse arrangement, rather than a full 8 percent capital charge on the assets sold. In doing so, I think the bill takes the right approach to addressing the regulatory concerns and removes what I consider a major impediment to securitization to date.

PSA supports S. 384 because it represents a sound approach to addressing the illiquidity of the small business market. The bill correctly identifies and specifically addresses the vast majority of legal and regulatory impediments that currently exist for a purchaser of small business-related securities.

As I explained in my written statement, PSA supports a legislative proposal similar to section 10 of the bill related to the REMIC treatment for asset-backed securities. Section 8 of the bill related to capital standards for banks that invest in securitized small business loans, or that sell loans with recourse, addresses some of the problems associated with credit support structures for small business-related securities.

The bill's change of regulatory capital requirements for small business loans sold with recourse I believe is the critical ingredient to incent banks to sell or securitize small business loans.

Further, I think that if a bank did retain a small amount of recourse for the first losses, that retention would be sufficient to obtain outside credit enhancement from a financial guarantor or others and receive the necessary ratings, probably AA or AAA ratings, which would make a vast market available for these loans.

I commend you, Senator Dodd, and Senator D'Amato for having this hearing. I would like to add that I am sorry the bill does not go further and allow this kind of treatment for consumer receiv-

ables and health care receivables, which I think are also vital sectors——

Senator D'AMATO. That is our next bill.

[Laughter.]

Ms. JEHLE. And I believe that if you reduced the capital requirements for loans sold with a minor amount of recourse for those receivables, it would greatly expand those markets as well. Thank you.

Senator DODD. Very good.

Let's get one bill at a time here.

[Laughter.]

Senator DODD. Thank you, very much.

Ms. Smythe, thank you very much for being here once again. We appreciate seeing you.

STATEMENT OF MARIANNE K. SMYTHE, DIRECTOR, DIVISION OF INVESTMENT MANAGEMENT, U.S. SECURITIES AND EXCHANGE COMMISSION

Ms. SMYTHE. Thank you.

Chairman Dodd, Senator D'Amato, and members of the subcommittee. I really appreciate the honor of testifying today on behalf of the Securities and Exchange Commission.

Senator DODD. I want you to comment, too—and I saw you respond very favorably, and I thought it was very interesting—to the testimony of Mr. Richmond, who articulates his ideas to us. So maybe in your comments you might comment on that.

Ms. SMYTHE. Yes.

Well, just jumping ahead, the Commission has not had time to absorb the D'Amato measure and to comment on that specifically, but I——

Senator DODD. Absorbing D'Amato measures always takes time.

[Laughter.]

Ms. SMYTHE. But I think I am free to say that the Commission itself has, in general, been very supportive of efforts to create and to enhance securitization of small business loans, and I will mention that a little bit more in my remarks.

I do want to say on behalf of Chairman Breeden and Commissioners Shapiro, Roberts, and Beese, that they applaud this subcommittee for its leadership in pursuing this very critical goal of increasing the flow of capital to small business.

We recognize that, in considering this legislation, you are faced with a difficult challenge in some respects of easing the flow of capital without diminishing important investor protections. We recognize that this is not an easy balance to maintain.

I can assure you that the Commission does not regard these measures as offering an invitation for those who would commit fraud to have an easier time of it.

I can assure you that the Commission will do its very best to monitor the effects of these changes, keeping in mind that the Commission's primary obligation, as always, is the protection of investors.

Before discussing what I will call the "Dodd measure," let me just mention in respect to the D'Amato bill that the Commission also applauds your actions in introducing that measure. While we

cannot comment specifically on different items, I was very impressed personally with the commentary I have heard.

The Commission itself, as you may know, late last year through an exemptive rule to the Investment Company Act, freed structured financings largely from the clutches of that Act. And in fact, since the Commission's action in late November, we now have pending with the Commission two filings that would securitize small business loans.

I have a feeling, however, just from my own experience in this area, that the kinds of measures that are in the D'Amato bill are probably necessary to give vitality and life to this particular market to bring it into line with the secondary mortgage market. But again, I know that we will be pleased to comment specifically on the different measures as we go along.

But for now, I hope that is sufficient, sir, to say that this is certainly something the Commission has supported in the past and has taken its own actions in this area.

As far as the Small Business Incentive Act of 1993 is concerned, as you know, this legislation will amend the Investment Company Act to deal with various kinds of venture capital pools that could not function effectively if they were subject to the full bore of regulation under the Investment Company Act.

The Commission particularly supports the amendment to the Act that would create a whole new genre of investment company, a company that could be owned by sophisticated investors and would not be subject to the 100-investor limit.

We believe that those investors, the sophisticated investors which Chairman Breeden testified about last year would, through Commission rules most likely initially be qualified institutional buyers and high net-worth individuals. The Commission believes very strongly that this kind of investment company freed from the strictures of the Act could well create flows of capital to small business. The Commission also supports amending the Act to deal, for example, with BDC's. Let me comment a little more on BDC's.

Some of the changes that are proposed in this legislation could increase risk. Increased leverage, for example, could disadvantage equity holders and holders of subordinated debt. More complicated capital structures could be confusing to investors. In fact, in our written statement we point out that in this area these changes depart more radically from what your predecessors of 53 years ago did than any of the other changes.

But as I think you have mentioned in other contexts, if Congress sticks with what it did 53 years ago, we would all be in a lot of trouble.

But you should be aware that the Commission does not believe that these departures—with one dissent—would pose an undue risk to investors, and various safeguards that are in the legislation we believe would be sufficient to address the increased risks.

Obviously, the Commission supports raising the single-state offering limit from $100,000 to $10 million. Clearly there cannot be any investment company in the United States that can make any kind of money on any investments if they are limited to $100,000. So I have a feeling there are not any investment companies to take advantage of that exemption.

[Laughter.]

Ms. SMYTHE. And $10 million, frankly, may not be enough.

And finally, the BIDCO bill, while we have heard some people suggest that perhaps there ought to be some allowance for greater interstate sales of BIDCO securities and not so much of a confinement to the State in which the BIDCO legislation exists, the Commission does not agree with that.

It believes that at least initially having the State where the BIDCO exists have a real interest in what is going on with that BIDCO, provides a good measure of investor protection.

And the 20 percent that can be sold out of State is simply to recognize that so many of our cities are on rivers, and across the river is another State. It is very difficult sometimes to prevent sales of securities across a State.

Thank you, very much.

I will be glad to respond to any of your questions.

Senator DODD. Thank you very much, Ms. Smythe.

Mr. Guthray.

You have had such terrific advance billing here. This had better be terrific.

STATEMENT OF BARRY GUTHRAY, DIRECTOR, MASSACHUSETTS DIVISION OF SECURITIES, BOSTON, MA; PRESIDENT, NORTH AMERICAN SECURITIES ADMINISTRATION ASSOCIATION

Mr. GUTHRAY. Chairman Dodd, Senator D'Amato and Senator Murray. I guess I have a reputation that precedes me.

As this is the first time I have appeared before the committee, I guess I have not been the firebrand State regulator who I guess protects my turf personally, but I guess that is what I am straddled as as the image. I would like to state for the record that I hope that is not my personal image certainly in Massachusetts.

I think that I have tried to move NASAA toward a far more proactive response in the small business area.

On behalf of State Securities Regulators, I am pleased to offer support for most of the key concepts in the Small Business Incentive Act. Those particular things that we did not support were primarily because we do not have a position on them. So in a sense, I think we strongly support the bill.

There are two provisions especially I would like to comment on because I think they have a State implication.

One is raising the exemptive power from $5 million to $10 million under the Securities Act.

I think one of the things that I personally would like to move the States toward is establishing with the Commission a better regime to register small business offerings whereby you really only have a principal regulator, rather than our overlapping system at the moment. I think we are moving toward that in the recent Regulation A area which I think could even be moved up to the $10 million limit.

The other comment I will have is about interstate offerings. Marianne I think suggested this in terms of the BIDCO. I would also like the Commission to relax its rules on interstate offerings.

This is not so much the States' interest as it is the American Bar Association. The States are aware of this.

Commission Rules at current make interstate offerings in New England virtually impossible. The reason is because the economic units do not necessarily conform to the State boundary units, it is virtually impossible to do interstate offerings under the Federal securities laws.

I think the SEC needs to be less protective of especially policing the issue.

However, we do have serious reservations about the other bill that is before the committee today—and that is, Senator D'Amato's bill. I would like to emphasize at the outset that it is not the concept behind the bill that the States have problems with. In fact, I applaud Senator D'Amato for opening up a debate on securitization.

I think it is clear that in the current world, commercial banking is dying in favor of investment banking; and that the banks are more as a facilitator rather than commercial banking anymore, and that securitization of everything is the way we are going.

Senator D'AMATO. I trust you are not looking for employment with the commercial banks later.

[Laughter.]

Mr. GUTHRAY. Well, OK, you are just following a trend, but I do think that you have reached a key in terms of getting money to small businesses, and that is securitizing the loans.

I think the States have two concerns here.

One is that, though we are not experts in the area, we do note that the loans are not homogeneous, as has been mentioned by other people on the panel, and I guess we are concerned that it could cause a confusion.

There is an article in the current issue of Forbes on——

Senator D'AMATO. On what are they confused?

Mr. GUTHRAY. Well, I was just going to infer that in the current issue of Forbes, Laura Joresky goes to the secondary mortgages and can show——

Senator D'AMATO. Careful.

Be nice now. Go ahead. Is this the Alice in Wonderland test?

Mr. GUTHRAY. Yes, the Alice in Mortgage Land test.

I wanted to emphasize that the States are concerned with the retail investor. I think that most of the asset-backed securities, or structured financing, have been institutional investor-oriented.

To the extent that I think the investment banking community is primarily interested in this market—that is, the institutional buyer and the high-net-worth individuals—the States are not concerned.

So I guess from the States' point of view, they would first of all, because there is a study going on, suggest that the subcommittee await that study.

But if they figure that the crunch is so extreme that the 6 months would be detrimental, we would therefore recommend that the bill be tailored more to meeting the market, which I think is really the market that most people are aiming for, and that is the institutional money. That is where most pooling has been done.

Relatively little of it has been sold on the retail market, except indirectly through mutual funds who buy these pooled products, and that is what the States are recommending.

Specifically, the States are troubled that there is that blanket preemption. I, for one, would not have supported the blanket preemption in the 1984 bill. I do not think there is a record to support preemption.

I have to remind the subcommittee that when we are preempted, the States are deprived of regulation. Therefore, we can't do anything.

I think even in the Secondary Market Rule there has been very little retail sales. This small amount of retail sales that has been done has been like in the mortgage, as Laura Joresky's article points out.

I also note that the NASD has had to clamp down on its securities dealers in the collateralized mortgage obligations, the CMO's, because they too have been sold, and I think the NASD has recognized it, in somewhat of an irresponsible way to the retail investor, which also lets me emphasize that I think preemption is false economy.

Because when you preempt the States—that is, we cannot control these things in the registration mode—most of our complaints then come that we have to police the individual sales transaction.

When the States have to police the individual sales transaction, it causes an increase in enforcement fees which is passed on in the form of higher brokerage fees for registration, and those are passed on to the customer in the forms of higher commissions.

Senator D'AMATO. First of all States have 7 years to exercise an option as to whether or not they want to opt out the Federal regulatory scheme for the secondary mortgage market—isn't that true?

Mr. GUTHRAY. That is true. But I think——

Senator D'AMATO. Let me just finish. Any State that wants to can opt to come into this regulatory scheme and can opt out of preemption.

I would note that under the 1984 law, which you said that you wouldn't support tens of billions of dollars that have been made available to people for refinancing. Without that law, there would not be the liquidity in the secondary market that exists today. Thank God, you weren't here in 1984 to testify against it.

Has the State of Massachusetts opted out of the Secondary Mortgage Market Enhancement Act preemption provisions?

Mr. GUTHRAY. No, you have not.

Senator D'AMATO. Why?

Mr. GUTHRAY. Because the lobbying power of the securities industry is so much greater than we would ever hope to see, we wouldn't even try to introduce the measure.

Senator D'AMATO. I said the lobbying power of the 50 groups that you represent who don't want to lose power and empower people to get credit is now being made the voice which really doesn't accurately reflect, Mr. Guthray, what people would want. The fact is that the State of Massachusetts has not opted out—but it could.

Mr. GUTHRAY. Not anymore.

Senator D'AMATO. It could have.

Mr. GUTHRAY. We could have.

Senator D'AMATO. Massachusetts had 7 years to opt out and you chose not to opt out. Is that true?

Mr. GUTHRAY. I didn't personally.

Senator D'AMATO. These mortgage backed securities are still subject to regulation and enforcement powers of the Securities and Exchange Commission, and nobody has ever accused them of being anybody's lap dog.

Mr. GUTHRAY. May I respond?

Senator D'AMATO. Certainly.

Mr. GUTHRAY. The reason I think we haven't opted out, and I don't want to say there's a problem, is that I have said most of I would say, and perhaps people on the panel are more experienced with this. The vast amount of secondary mortgage activity has been to institutional buyers. It isn't a retail issue. And I am not saying we should opt out because——

Senator D'AMATO. Don't you think the vast majority of buyers in this case, particularly given the hybrid nature of the loans, are going to be institutional buyers?

Mr. GUTHRAY. Of course. All I am saying is I don't think there's a case for preemption. I don't think there was a case in 1984. In the sense I don't think the States are an impediment. I am really not saying there's a problem. All I am saying is that, should it turn into a problem, you have robbed the States. And there have been no scandals in Massachusetts.

Senator D'AMATO. Let me just correct that now. S. 384 does not preempt State antifraud laws or State regulations or brokers or dealers that sell or trade small business-related securities. Therefore, under the bill, the States are free to deter and prevent fraud or other abuses in the sale of small business-related securities.

Mr. GUTHRAY. My response, like I say, is I think registration is the cheapest form. Particular individualized enforcement actions between one customer and the broker are the most expensive form.

Senator D'AMATO. You've got a problem, though, Mr. Guthray. The problem is, we need to get credit to small businesses. And one of the ways to give incredible liquidity to tens of millions of Americans is through securitization—which is what we are attempting to try to find a way to do. In a more complex situation we are trying to provide a methodology of giving that liquidity again to banks for the purposes of making loans that they would ordinarily make but that they can't because of constraints such as reserve and the competitiveness for dollars, et cetera.

Mr. GUTHRAY. And I support that fully.

Senator D'AMATO. Good.

Mr. GUTHRAY. I just do not think this State regulation is what's an impediment. And I agree with you it's very, very good. I don't think it would have made an ounce of difference, personally, if the States had been given full power in 1984 to State regulating.

Senator DODD. I think that point's been made here. Let's move on to some other questions. We're going to go round and round on this.

Mr. Rennie you raised the issue that there seems to be more offshore financing. I am intrigued by that comment. I am not disagreeing with it at all. I think you also pointed out the fact that

one of the unique features of our country is the presence of a small business community and the absence of one in the other two blocs.

Why is off-shore financing available for small business here? Of course, there seems to be some form of an incongruity with the absence of a small business community in the other blocs.

Mr. RENNIE. Well, interestingly enough, Mr. Chairman, it's available because they have a high regard for the small business community of the United States. And the problem is in western Europe, for example, which is the nearest to us, sort of the nearest model, the difficulty is in western Europe is that the risk/reward situation is totally different than here. And it's a cultural thing that if you enter—start a small business and you're successful, you're fairly heavily taxed and there are very limited ways, although they've improved in the last 10 years, of how you can liquid up, other than selling the company they have now a certain amount of small business trading.

But on the other hand, if you fail in small business in Europe, you are—it is devastating. I mean, you have a black spot on your forehead. People have to change their name and move to another country, because you are basically almost unemployable.

So there is a perception that if you start a small business—and I have met small business people in Ireland, like this—if you start a small business there and you fail, it's a tremendous downside risk. And as a result, that's why they don't have the startups.

When they have the startups or when they have legitimate or good investing opportunities, then the overseas capital does invest overseas as well. But they see more opportunities in the United States. And that's why they're very interested in this community.

Senator DODD. Let me ask all of you a general question. We've had a lot of different ideas kicking around here this morning. Obviously you've heard the complaints from small business and others that the regulatory scheme, just the nature of how the regulators are reacting, has created its own set of problems. Some of the issues that relate to that directly have been raised with FIRREA.

There is a whole host of other solutions such as a capital gains tax reduction. Some people have talked about that as having the potential of being of some assistance in all of this.

I wonder if you might try and share with us some sense of what is occurring out there in terms of the access of capital or credit to small business and how it relates to the overall economic concerns. And you point out, Mr. Gladstone, some of the legal problems and so forth. They're not minimizing those at all.

But are we looking here primarily at a question of what we have imposed or what exists out there today through a regulatory scheme that is the larger impediment and the attitude of regulators? Or is it because they are more attractive vehicles and instruments for the traditional sources of lending, primarily banks. More attractive instruments for them to be involved in than the traditional commercial loans. We obviously know the problems with real estate. But nonetheless is that having a greater impact?

I realize I am asking a difficult question to apportion. But I would like to get some sense from you because we up here hear from both all the time. We have some come and complain like hell that the regulatory scheme is not that overburdensome, that the

banks just don't want to go that way. It's too attractive to be in credit cards and T-bills and other things, why should we go this route. And obviously the other side of the coin is that it is the regulatory scheme. It is the legal problems and the like that are creating the problem here.

Why don't we start with you, Mr. Rennie, if you want.

Mr. RENNIE. Well, Mr. Chairman, I think a problem we had about a year ago in our company might be instructive. I would conclude from our experience that it probably is more the impact of the regulators than the overall economic prospects.

Now, it's hard to infer that maybe on a broad sense. I'm sure broadly it's true. But a year ago when my company, which is a growing company and, you know, has good prospects, so forth, so there is no question in the banker's mind when they are addressing us whether our markets are going away or anything, because we are fairly broadly based. Nevertheless, we had a situation where the U.S. Government that we do a lot of business with, had lost an entire month's worth of receivables. Basically, they had lost a whole month's worth of invoices. And so unexpectedly we had to—we thought we would have to borrow for a short period of time from a credit line that we had had and had been paying for since 1986 but had not used.

And we had, at the moment, at the time we approached the bank, we had about $2 million in the bank. This was a million dollar credit line. And we said it looked like we were going to have to use $300,000 of the credit line for a few weeks until we could find these stupid checks and get them in.

Immediately, they changed the whole thing. They said, you can't. We've got to change the whole structure of the loan. It went to a guarantee loan instead of unsecured. It went to a secured loan. The costs went up. It cost us just to redo the loan, just the legal things. And we had to wrestle with severe covenants that they wanted to put in and so forth. It was like an immediate changeover.

Now, they knew—we're a 25-year-old company. We had been with this bank, which is a large bank, for 14 years. We're a well known company and so forth. They knew that there were Government receivables that we were going to get in in a short time.

Now, it seems to me that that kind of a reaction strikes me as more that they were reflecting the pressures on them from the regulators than they were worried about whether our long term prospects. Now this may be, again, this anecdotal thing. But to me it was somewhat instructive. And I would conclude from that little experience that way. Others may conclude differently.

Senator DODD. Go ahead, Mr. Baker.

Mr. BAKER. I would just like to comment. I think it is not a single issue problem. It is more the perception of what the regulators may do, than what the actual regulation says. There are an awful lot of banks in middle America that have been providing character loans, what some of them call equity loans, which is somewhat of a conflict of terms, to small businesses. When they anticipate regulatory problems with those loans, they scale back to something that fits very neatly within their policy manual for making those loans.

And I think that is really where many of the problems for the smaller companies and the smaller loans have really come from.

And of course when you look at that, then you can look at other alternatives to invest your money as a bank and say, of course, there are other attractive alternatives.

Senator DODD. Mr. Widen.

Mr. WIDEN. I have been involved in the small business arena here for probably 20 years, back in the early 1970's when I started my first company. Ever since then, we have obviously gone to the bank as the most convenient method of financing. And I have always found that they are very comfortable with a receivable—some kind of a rotating receivables package. You know, if you put some T-bills in their bank account, you know, you can borrow against that. They have not been aggressive.

In my second company, we were able to get an SBA loan for about $500,000, and things have gotten worse, as you are aware, up in the northeast. So I would not say that necessarily is legislation. I think it is kind of a mindset and until the condominium developments and the real estate market went down the tubes over the last 4 or 5 years, they have had a very willing and what they believe a very good vehicle where they could place their money. They were not familiar with the small businessman.

As someone stated earlier, there are too many venues, too many different kinds of companies doing very many different kinds of things. They had the condominiums and the cars, that kind of thing. So I think it has been a universal deal over the last 20 years.

Senator DODD. Mr. Gladstone.

Mr. GLADSTONE. Trying to put it into perspective again, I think regulation is probably 40 percent of the problem in terms of banks lending. They have a tremendous overhang every day as they work through the regulations. And usually there is a regulator in the bank. Litigation is probably 20 percent of the problem.

Capital gains doesn't stop an entrepreneur from starting. The Jeff Widens of the world will always start businesses, regardless of what the tax is. But the problem is, bringing on the number two and the number three and the number four person is very difficult to attract.

If I go to a large company and I ask someone to leave to become a number two with Mr. Widen, they want to know what kind of stock options and what kind of upside they have. They are much more in that mode. So getting the second through the fifth person is very difficult. And so I think that there is something to be said.

Probably 20 percent of the problem has to do with the economy today. Loan demand is down. There are not that many people—if you are a successful small business owner today, why take the risk to open up the second shop in this kind of economic environment.

Senator DODD. I wonder how much is a self-fulfilling prophecy. The chatter around the street is it's just not there. It just sort of predicts itself.

Mr. GLADSTONE. I think maybe 20 percent of the problem is economic climate. Loan demand is down at banks and everyplace else. And you have to take with a grain of salt the idea that loan demand is down. There is plenty of loan demand. It is the selection of loan demand.

The individual that comes into my office who says, I need money to meet payroll on Friday, is a very different kind of loan demand than the person who is building a business and needs the next layer of debt or equity financing to grow it. There is plenty of loan demand, but there is not loan demand of the type that a bank is willing to take. And so it leaves many more people out in the cold in terms of getting the lines of credit.

Senator DODD. How do you get that data? I don't know whether Senator D'Amato has the same experience. We get inundated. I bet we have had three inquiries this morning already. Literally where these are expanding or trying to do something and where they've been turned down. We try to do what we can, obviously.

Frankly, the job of Senator in such a case, to be an ombudsman between my local bankers and borrowers, is not something that I particularly enjoy doing. And yet we get inundated with it.

I have tried to get data to try just what you are talking about on how you determine what is coming through and what is being accepted. And it is very difficult.

Mr. GLADSTONE. I can only speak from our portfolio. Every Monday morning we go through all of the loan requests and the deals that have come in during the week. We get a sense of what is happening in the marketplace. So this is really a perspective from Allied.

We have about 2500 loans that we have made that are in the portfolio. And probably over our life we have seen hundreds of thousands of opportunities. So I am speaking from what our statistics show within the firm, not something that would be out in the open.

Senator DODD. Ms. Cloherty, do you want to comment on this?

Ms. CLOHERTY. Yes. Perhaps being in my role as equityholder on the balance sheet, I have a slightly different view. The thing about the problems that the businesses confront in the economic environment, we did it to ourselves. God didn't do it to us. I mean, we have been through a period of excess leverage at every level. I am speaking governmental, corporate, and individual. The leverage on the downside is vicious. And it is reenacting what we already knew before it started.

There is a healing process under way. And the banks—and there was a regulatory response to the activity.

Now, as always when the pendulum swings, it probably swings overmuch. And the banks have been in bad shape. I mean, they have had to rebuild their capital. And they do it. And clearly with Government in the debt markets as it is and the position of interest rates, it is simply more profitable for them to go into Government paper. You would be crazy not to. I mean, in the end there is not a culprit here, except all of us who participated in the activity and took advantage of leverage on the upside and have to live with the consequences.

So I think that while it is smaller businesses—and God knows there are companies in our portfolio I have spent the last 3 years in pitched battles with at least six banks. And I mean—I do what we all have to do.

Senator DODD. I have a feeling that you probably won most of those.

[Laughter.]

Ms. CLOHERTY. I did. You give them the keys and then they get scared.

[Laughter.]

Ms. CLOHERTY. The fact is that the owners end up having to put in more capital or write them off. And that happens with individuals as well. They are faced with a bitter, bitter decision. Do I take money out that I have made historically, put more equity into my business, or do I fold it? And they do this. I mean, these are terrible things.

Individuals have been overreached, so they have less capital. Our central issue is to rebuild net worth. And that requires equity for better or for worse. And I mean the role of Government seems to me in this activity in the end becomes a counter-cyclical one of helping the healing process. And I think that these guarantees and the securitization is a route that you can go because, particularly if you are not squandering full faith and credit guarantees of the taxpayer but subjecting it to private market scrutiny where people will in fact buy the piece of paper because it carries a rate that is appropriate to the risk at hand.

So again, back to your bills, I mean I think that is what is being discussed here.

I have to say I don't find the—I understand the economics of what is happening. Capital is king and equity will be scarce, because that is an integral ingredient to rebuilding net worth, because the only way you do it is building new wealth. You have to have growth.

Senator DODD. Anyone else want to comment on this? Maybe we've exhausted it unless someone has some additional thoughts.

Ms. JEHLE. I have a lot of bank clients that are heavily capitalized that have lots of liquidity that have chosen to buy lower risk-weighted assets than to invest in 100 percent risk-weighted assets. The math or profitability math works for buying Treasuries, for buying mortgages, for buying 20 percent risk-weighted assets. And the cost of capital imputed into keeping something with 100 percent risk weighting, the math doesn't work. The yield would be too high they would have to charge too much for a small business borrower to make it work.

Senator DODD. But what we are suggesting may help out that particular problem.

Ms. JEHLE. There is a great decrease in the amount of appetite for credit risk. A decreasing appetite for credit risk in the system. There are a lot of banks that are working out their real estate problems and so forth that cannot administratively handle any more credit risk workouts.

But I use the example of well capitalized banks who used to be bigger factors in middle market lending and small business lending who have withdrawn because it is more profitable to buy securities.

Senator DODD. Senator D'Amato.

Senator D'AMATO. Mr. Chairman, let me if I might, with the panel, raise two questions and ask Ms. Jehle and Ms. Cloherty if they might want to comment, or anybody else. I think Mr. Gladstone already touched on several additional impediments to securitization.

The legislation S. 384 is designed to remove impediments to securitization of small business loans. Are there additional impediments that are not contemplated by this bill that should be addressed? And, if so, what are these impediments and how would they impact on the creation of a secondary market for small business loan-backed securities? That's one question.

The second question, there have been a number of proposals or a proposal in particular which would establish a Government-sponsored enterprise for small business loan-backed securities. Is there any way to establish a Government-sponsored enterprise without the implied Government guarantees? I am not necessarily talking specifically of the legislation introduced in the House.

I believe that there will always be that implied guarantee when the Government is involved, and consequently you involve the taxpayer in this. The concept of securitization their loses its attractiveness to many of my colleagues who say, we don't want the Government undertaking any additional exposure.

Ms. JEHLE. In response to your first question of whether there are other impediments, I'm not sure how the Community Reinvestment Act plays into this with the sale of the loans by the banks does the bank get CRA credit for the loan sold? That would be important to them when they originate the loans to be incented to recycle the proceeds back into small business loans rather than again divert them to something more profitable.

The mortgage market has recycled proceeds back into the mortgage market, both because of the incentives and because the math works. So that would be one suggestion that I would have on that point.

I agree with you that a GSE would have an implied Government support to it. And without Government support, I don't see what a GSE would provide.

Senator D'AMATO. It wouldn't provide anything?

Ms. JEHLE. I don't think as an intermediary it is necessary to be successful. I think a banker, any intermediary pool could do it if you're not going to have a Government guarantee.

Ms. CLOHERTY. I am not familiar enough with debt securities to comment in a creative fashion.

Mr. GLADSTONE. Securitization would be a wonderful thing for us being able to sell our small business loans. We are one of the few nonbank lenders under the SBA 7–A loan guarantee program. We make loans available, about $50 million a year, as one of the larger players. That securitization program works wonders because of the full faith and credit.

Senator DODD. How burdensome is that? Is it a burdensome process for the lender?

Mr. GLADSTONE. We have people who do it every day, so it seems to work fine. There are about 100 sheets of paper to complete in one of those loan packages. But if you do it for a living, it becomes very easy after a while. We have most of it computerized so it is on screens. And we're able to print it out.

So from our standpoint, it is easy. There is probably a barrier to entry. You asked why some banks don't do it. That is probably a big barrier to entry for those banks coming into that program.

On the other side of it, though, is there some other way of doing it without a Government guarantee? I can only look at the experience of Resolution Trust and their securitization of small business loans and selling them off. They are getting about 60 cents on the dollar now, with 30 cents to come sometime later and 10 percent holdback. I think that would be unacceptable to any commercial lender. Only the Government can withstand that kind of capital infusion in each one of the loans.

But they are proving a marketplace is there at some price. And to that extent, we are moving in the right direction. If you can get it to 90 percent of your money out or maybe 85 percent of your money out, you could probably make the system work.

But I think anything less than getting 85 cents of your dollar back is probably not going to suit any of the bankers or other financial institutions.

Mr. BAKER. I have a question for somebody else on the panel who might be able to answer this. As I understand it, we securitize many other types of loans currently, like auto loans, and some types of equipment leasing. Is that true? Could those kinds of mechanisms be used if we could somehow standardize small business loans at least to some extent?

Ms. JEHLE. I think that some variation on the auto and credit card securitization technology would because to package a small business loan. I am not so sure standardization is necessary—it would be nice. There would be a convergence on the standardization as capital market investors showed a preference in price for one standard over something else. And then the whole market will migrate that way.

We have packaged a lot of different types of loans into one pool and sold them. We basically deal with institutional investors. They are very savvy. They understand the complications and the diversity in the pools and they don't have a problem with that.

Senator DODD. And you are also creative in giving some degree of predictability. I chatted with somebody the other night about the President's idea on guaranteed student loans. Based on career choices, your payback would be different. The point he raised was very good. If you want to securitize those loans and sell them in the secondary market, how are you going to be able to sell that loan if you're picking up the loan as someone is moving into the higher education institution not knowing where they will be when they come out.

But I said, I promise you, Senator, someone will figure this out very quickly. It's too good of a market.

Ms. JEHLE. Absolutely. People will segment the loan into its' certain parts and its' uncertain parts and somebody will buy each at a different price.

Senator DODD. I didn't mean to interrupt.

Senator D'AMATO. Mr. Chairman, I don't have any further questions.

I want Mr. Guthray to know that—maybe I was a little tough on you. But it is not personal. You state, obviously, very legitimate concerns. And that is to see to it that the protection for the consumers be there, that we open the door to individuals to come in and hustle, so to speak.

You mentioned the Forbes article. And I might mention to you to read that carefully, because there is a big difference between the Fannie Mae securities mentioned in that article and S. 384. Fannie Mae securities are not registered with the SEC because they are issued by the GSE but the securities issued under S. 384 would be registered with the SEC.

It becomes clear that one of the benefits of not having the GSE is that you have the protection of SEC registration. I know that the State regulators and the SEC work hand-in-hand—and we want to keep that coordinated effort.

We don't want to usurp State rights; we want to work with the States. I wouldn't be a bit surprised when S. 384 or a form of it is enacted in the State of Massachusetts.

Senator DODD. You want to comment on that?

Ms. SMYTHE. I want to comment briefly on your question, what might there be out there getting in the way of small business securitization.

As I mentioned, the Commission last year through an exemptive rule attempted to exempt the kinds of financing that small business securitization would require from the Investment Company Act. We hope to hear from the investor and business communities about whether the Commission's action was sufficient. The line between what is an appropriately circumscribed exemption under the Investment Company Act and what essentially goes beyond the Commission's exemptive authority is often difficult to draw.

So we will be listening for that as well.

Senator DODD. I should have been made known of this. I appreciate what the Commission did. You responded to this, really, without us. We talked about it, but you tried to ease up some of the regulatory burdens on your own. And the Commission ought to be commended for that.

Ms. SMYTHE. I will tell them.

Senator DODD. I have one additional question. A couple of weeks ago, the Wall Street Journal published a special report on black entrepreneurs and minority-owned small businesses in the country. This survey said 83 percent of those surveyed said that raising capital was a very serious problem for black-owned businesses. Eighty-four percent said the lack of capital was a major reason for the relative scarcity of black-owned businesses. On the average, 83 percent of the financing for black-owned businesses was found to come from personal savings with 70 percent of the respondents saying that they relied entirely on personal savings to finance their businesses. Lending institutions had provided only 6 percent of the capital necessary for them.

I am not going to debate this point. It is obviously a trend that needs to be reversed dramatically. We talk about Enterprise Zones and a lot of these things. I am supportive of Enterprise Zones. But somebody pointed out the other day, that there is a notion of an Enterprise Zone of a white-owned business moving into an urban area. And the idea of having black entrepreneurs or minority entrepreneurs spring from their own communities is, for me, ultimately where we've got to be moving if we're going to create economic growth and jobs and so forth in these areas.

I suspect there is no real debate about whether we ought to promote it, and it is a trend that has to be reversed in my view. I wonder if you might comment on some of the problems of minority-owned businesses.

Let me give you some thoughts as you are mulling over your response to me. Diane Thomas who is the executive director of the Entrepreneurial Growth and Investment Institute said in a Wall Street Journal report that banks are reluctant to lend to minorities. I am quoting her, "Because of their low level personal wealth to offer as collateral." That was one. And two, and I am quoting her here, "investors are not familiar with the minority business community and their markets." Third, and I am quoting again, "minorities have a lack of significant corporate experience."

I wonder if the panel, those who feel that they would like to, would like to comment on this general problem.

Mr. Guthray.

Mr. GUTHRAY. One of the projects that we had under way in Massachusetts was the SCORE program. And over the last year we have had probably 150 conferences. I would note that in those conferences one of the really significant problems is the small businesspeople cannot afford the professional fees of the industry professionals. They are not interested in them, they charge them too much money. That is the brokers and so forth, to place their debt. And they don't know where to turn.

And I think one of the things that I have noted, and I guess it is in a sense of weakness in the other departments in Massachusetts, is no one helps these people. I would think with the minority community especially they simply don't know. No one is out there to give them any help at a lower or even free cost to get going. And they don't know where to go. And the capital markets in a sense are very foreign.

I am not criticizing the professional community because they have to make a living like anyone else. But it is very difficult for these people because they don't have the fees to pay and so forth. And someone goes and says, you know, I want 10 percent of your money to raise it and so forth. It is just—I really think that one of the keys on that is just providing better public information to these people as to where capital is. Because I don't think they know. And I think that is true of especially the minority communities, the banks. They turn to the banks and the banks just say no.

Ms. CLOHERTY. I again have a slightly different view. I think the minority community is not monolithic. It is like every group, very, very different. And there is a pipeline effect. It is no different, really. Women have been in much the same position.

In my early years in the venture capital business, I saw one black entrepreneur and one woman in the first 8 years in the business. Now, today, it is totally different, a totally different picture.

The entrepreneurs that we see tend to be people who have been through—have had a relevant education to what they propose to do. And in general, they have been in the pipeline of the relevant corporate experience. We don't have people come—they come into the lead business from the lead business and so on.

And we are finding, and I think it is very highly encouraging. We are developing a pipeline at the venture capital level of seeing a very diverse group, which means, incidentally, that the individuals generally have had an opportunity to build up—I mean they've got a savings account, they've got a nest egg, and that's what they are prepared to put at risk.

My experience in the small business population being such a person is that they don't pay fees. I mean, I hate lawyers fees, for example. They will always horse trade, you know. Accountants get stiffed and all.

[Laughter.]

Ms. CLOHERTY. I think the minorities don't have expertise in that. If they don't as much as I do, then I will train them. I have been encouraged. I think that you just have to, you know, keep open and like women also they are in abundance. People like Bruce Llewellyn who owns a Philadelphia bottling company. And there are role models. There are more prominent entrepreneurs in the minority community, I think, that have been starting to inspire some of the younger ones.

And one final thing, because I am babbling a bit here. I do think the SBA's, SSBIC program formerly known as MSBIC, it's performance was lumpy over years. The businesses, apprentice business, and I think out of all of that experience you will start getting the seasoned base of entrepreneurs with experience and some managerial capability.

Mr. GLADSTONE. Our experience has been just the opposite of that reported in the Wall Street Journal. We have a wholly owned subsidiary that does nothing but—we used to call them minorities. We're on to disadvantaged. I noticed in the annual report we're calling them challenged people at this point. In time we have approximately 25 percent of our assets in those kinds of loans and have had no better, no worse experience with them. And we have plenty of money available. So if you have people calling your office that need loans, send them to us. We would be very desirous to see them.

Senator DODD. If this morning's hearing gets any dissemination you may hear.

Senator D'AMATO. May I do the same thing?

Mr. GLADSTONE. Yes.

Senator D'AMATO. You're going to be a busy guy.

Mr. BAKER. I will not address the access to credit problem further. However, far out in the access, the capital area there are venture capitalists out there and if you are an opportunity that they want to take advantage of, they will find you or you will find them.

Most of the people in that survey, are in the middle-risk, middle-return market. Right now we have business angels, and other entrepreneurs, that have been successful. Raising capital is very, very much a relationship business. And if you don't have a relationship with somebody that has been successful, that has money and wants to put the money into a business and trusts you, if you don't know that person, you're going to have a very, very difficult time finding them until we put some sort of organized effort into filling that gap, such as BIDCO's and a couple of other programs.

And certainly there is a minority BIDCO program in Michigan that has been very, very successful in dealing directly with minorities. BIDCO's, again because it is an organized financial market, they are available, there is a place for some of those people to go. And it is where the middle-risk, middle return opportunity can actually find capital.

Senator DODD. Do you want to comment on this?

Mr. RENNIE. I would just add the comment that I think the difficulties that the minority community encounters are probably just exaggerations of the general community. In other words, the general community would have problems. But because of the fact that they just are not as experienced, there have not been as many black entrepreneurs and so forth coming along, they have not quite filled up the pipeline.

And I think Ms. Cloherty's comment about the women, for example, now having been—they really kind of in the last 10 years have really metamorphosized quite a bit and they have really entered the capital markets much more. The minorities need to do that. And it may take some time.

The one way you can accelerate it is, as Gary suggests, you have to put in some kind of a focus group. If you have a subsidiary that is particularly aimed at minorities or disadvantaged or whatever euphemism we use, the fact of the matter is that will build up experience because of this kind of marketplace, that counts, relationships, experience. It may seem somewhat prejudicial and it is in a sense. But it is prejudicial only because of the currency of the dealings that we are involved in here.

So I think the stats are probably accurate in the sense that I would expect to see minority community stats being an exaggeration or kind of a megaphone of what the basic problems of all small businesses would be.

I think as our experience grows as they get into the mainstream of the business, then it will improve.

Senator DODD. We can wait for that to happen, but it seems to me as well, that just looking at it purely without any knowledge base at all, I would suspect that one of the reasons that she cited is the investors not being familiar enough with the minority business community.

I suspect if I had to pick out one, that that would be the one that would be the difficulty. What knowledge base? If you're not from that community, it is difficult to understand how the consumers react within that community. How do you promote that and expand that.

Mr. RENNIE. I can see that in very small retail situations or something. But if you go beyond that, basically a business is a business. If you had a piece of paper, not seeing who owned it, and you read a business plan and you read a business description and it said it was a company of a certain type, most of the financial people, whether they are bankers or investors would size it up on that basis.

And then the person walks in and happens to be a person of color. But the assessment would be on the marketplace, what they're doing and those kinds of things. Other than outright bigotry, you know—well, now that I see it is someone of color, I'm

not—but the cultural aspects of it I don't think would enter into a financial decision that much.

Senator DODD. I hope you're right.

Mr. BAKER. One quick comment. I think we would all agree that raising capital is a contact sport and you need the contacts.

Senator DODD. I appreciate your comments.

Al, do you have anything else?

Senator D'AMATO. Mr. Chairman, you're going to comment in a little detail on our friend Marianne Smythe?

Senator DODD. You have served many years and I understand that you are going to be leaving the SEC?

Ms. SMYTHE. Yes.

Senator DODD. Let me just say from this subcommittee chairman's perspective and our staffs up here, you have done a terrific, terrific job over the years. You have been a valuable witness before this committee on numerous occasions and a tremendous assistance. You have been a terrific public servant. The country is better off because you served, and I didn't want this hearing to end without thanking you immensely for serving this country. We appreciate it.

Ms. SMYTHE. I am just overwhelmed. Thank you.

Senator D'AMATO. Marianne, next time you come back as one of these great capitalists——

Senator DODD. You will be in business with Ms. Cloherty over here. The two of you. I can see it. Cloherty and Smythe. I can see it.

[Laughter.]

Senator D'AMATO. Mr. Chairman, before we close, let me thank you for your leadership in the area of concern for smaller business prior to this ongoing legislation, as it related to so many areas by attempting to create the opportunity for small businesses to flourish. You have been a leader in that.

And let me also commend our staffs. The staffs have just done great work for both the Majority and the Minority side. They have worked in a cooperative effort to bring us to this point. We have undertaken this hearing to try to improve the legislation that we have before us. There is no pride of authorship. If we can enhance it and make it work better, we want to do that.

Let me thank every one of our panelists. Mr. Guthray too.

[Laughter.]

Senator D'AMATO. It is better that we hear these observations from a learned person and a distinguished person in his field who points out some of the legitimate concerns of State regulators. I want to applaud you and thank each and every witness for their time and making the sacrifice.

We thank you for trying to make it better for the small business community. And we thank you, Mr. Chairman, for your extraordinary leadership in this area.

Senator DODD. You have been here 2½ hours sitting at that table. There have been some terrific suggestions. We are going to take them to heart and try to improve this. We will be staying in touch with you as this goes through the process.

It takes a lot of time and effort to get here and to spend the time to prepare testimony. We are deeply appreciative to all of you.

Hopefully we can move fairly quickly on this. I think we can develop some real consensus and take some positive actions to increase the flow of capital.

I thank you all for being here this morning. We look forward to an ongoing dialog with you as we try to increase the availability of capital and assist our small business community.

Thank you all very much.

[Whereupon, at 12:24 p.m., the hearing was adjourned.]

[Prepared statements and additional material supplied for record follow:]

PREPARED STATEMENT OF SENATOR ALFONSE M. D'AMATO

Mr. Chairman, I commend you for your leadership in pursuing ways to end the credit crunch for small businesses. It is particularly helpful to have representatives of both small businesses and the capital markets present so that we can find a workable means of providing credit to small businesses.

I would especially like to welcome our two witnesses from New York: Patricia Cloherty from the venture capital company of Patricof & Co. Ventures, and Patricia Jehle from the investment banking company of Bear, Stearns. I look forward to hearing from both of you.

The distinguished Chairman of the Securities Subcommittee and share a deep concern about the credit crunch—particularly the credit crunch for small businesses. As we have discussed at many of the Banking Committee hearings over the last two years, America's small businesses have been hit the hardest by the downturn of the economy.

The well for small business credit has dried up, leaving small businesses with few alternative sources of capital. As a result, small businesses have been unable to get the credit essential to buy equipment or inventory or hire new workers.

Small businesses are the engine of economic growth. Over a ten year period prior to the recession (1976 to 1986), more than 22 million new jobs were created in the United States. Small business accounted for 57.2 percent of this job growth. The number of new jobs created by small business is even more pronounced in my home state of New York. During the same period, small businesses contributed close to 70 percent of the almost one million new jobs created in New York.

Small businesses need credit to stay alive. Two weeks ago I introduced a bill, cosponsored by Chairman Dodd to enhance small business access to the capital markets.

The "Small Business Loan Securitization and Secondary Market Enhancement Act of 1993" (S.384) removes current legal impediments to the securitization of small business loans and the development of a secondary market for these securities.

My bill provides a sound approach to raising capital for small businesses. This legislation is designed to stimulate loans to small businesses without any cost to the taxpayer. It does not create a government agency or require a Federal guarantee—instead it opens up the capital market to small business and relies on the ingenuity and creativity of the private sector to make it work.

I also cosponsored the bill introduced by Senator Dodd on Tuesday, the "Small Business Incentive Act of 1993." This bill seeks to encourage capital investments in small businesses by venture capital funds, business development companies and others.

The recession of the last few years has highlighted the credit crunch. This problem will continue, however, unless we enact legislation to open the capital markets to small businesses. I look forward to hearing from today's witnesses on how we can put the capital markets to work for our Nation's small businesses.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF SENATOR PHIL GRAMM

The Chairman of the Subcommittee, Senator Dodd, is to be commended for beginning the work of the Subcommittee this year with the examination of legislation to increase the flow of capital to small businesses in America. It is well known that the great job-creating engine in America is, in fact, the multitude of small engines that are America's small business.

It is noteworthy that the legislative proposals under consideration this morning would increase the flow of capital to America's businesses not through any new government program or spending. Often, all it takes for business to flourish is getting government out of the way.

I am pleased to be an original cosponsor of S.384, the Small Business Loan Securitization and Secondary Market Enhancement Act of 1993, authored by Senator D'Amato. This legislation will remove some of the barriers to the creation of a secondary market in small business loans. While this will not likely result in an immediate surge in securitization of small business loans, it will certainly increase the flow of capital, and I expect that the amount of that capital, small at first, will grow significantly over time.

I am also supportive of the effort in Chairman Dodd's bill, the Small Business Incentive Act of 1993. As Mr. Thomas N. Richmond, Jr., representing the Securities Industry Association, says in his opening statement, it "is a good start, but further steps will be needed." The bill is the beginning recognition that our paternalistic se-

curities rules are outmoded and in need of being brought up to date, to the standard of the modern, global capital markets.

I would also like to take this opportunity to express strongly my support for legislation not before the Subcommittee today, but which should be passed by the Congress at first opportunity. I am referring to legislation repealing section 11(a) of the Securities Exchange Act of 1934. I know of no one who opposes this reform. No one has opposed it for years, and yet Congress somehow fails to make this minor change in the law. I renew my suggestion that this amendment be passed free-standing and not be made hostage to other legislative agendas. It is not a big change, certainly not one that can be a locomotive to pull any other legislative matter. It is just an unnecessary cost that should be ended today.

I again applaud the Chairman for these small business initiatives. They are clearly on the right track. We need to review other legislation that might have unintended negative consequences on capital formation—I hear frequent complaints about the implementation of the penny stock legislation—and take additional steps. I would hope that we could turn at an early date to the review of what I consider to be outmoded regulations that are preventing the listing of world-class foreign stocks on American stock exchanges. These rules are threatening to turn our crown jewels, the securities exchanges, into mere regional trading centers instead of the world leaders that they have been.

I look forward to the testimony that will be presented today.

PREPARED STATEMENT OF SENATOR JIM SASSER

Thank you Mr. Chairman for calling this hearing this morning. The issue of small business access to credit is of vital importance to the economy as a whole.

Small businesses are the largest creator of jobs in our economy. However, without access to credit, they cannot develop new products, expand their facilities, and create jobs.

This has been an economic recovery absent of jobs. Monthly job growth is a fraction of what it should be, and unemployment is higher now than in was at the trough of the recession. Indeed, we're only creating 23,000 jobs per month while ordinary job growth coming out of a recession is between 200,000 and 300,000.

To create these jobs, small businesses need capital to grow on. But traditional sources of credit have fallen short. Banks have been unwilling to lend, and the credit crunch has been most severely felt by small businesses.

The legislation that the subcommittee is considering attempts to provide greater access to credit for small businesses.

I look forward to hearing from the witnesses on this issue.

Thank you Mr. Chairman.

TESTIMONY OF JOHN C. RENNIE

CHAIRMAN AND CHIEF EXECUTIVE OFFICER
PACER SYSTEMS, INC.

CHAIRMAN AND PRESIDENT
NATIONAL SMALL BUSINESS UNITED

Mr. Chairman and Members of the Committee: I very much appreciate the opportunity to testify today on the vital issue of access to capital for the Nation's smaller businesses. My testimony is on behalf of National Small Business United (NSBU), a nation-wide small business advocacy group with over 65,000 member businesses from all states and across virtually all industrial sectors.

In addition, I can speak as the Chief Executive of my own firm, Pacer Systems, Inc. which is a diversified engineering and electronics manufacturing company. Pacer is twenty-five years old, has offices in six states and Europe and annual sales of $30 million. It is instructive, Mr. Chairman, that although Pacer is on the "high end" of our country's small business sector, within the past year or so we have had two instances where we have had difficulties in obtaining financing: One concerned short-term bank financing; the other involved long-term equity financing of a spin-off venture. If my company has encountered these difficulties, one begins to fathom the difficulties much smaller, less well-established firms are experiencing.

So, we would like to sincerely commend you and the other members of the Committee in placing a high priority on this extremely important area of policy. It may seem redundant to say it because it is now generally well-understood, but let me reiterate it once more: The recovery from the economic recession, especially expan-

sion accompanied by job growth, will be dependent on a strong and vital small business sector. Without small business leading the way, the recovery will stall or move forward at an atypically slow rate, ensuring continued economic dysfunction for an extended period.

Also, in the longer term, small business must be able to obtain affordable long-term capital for renewal of physical assets, training and retraining of the workforce, conversion of technologies into useful, competitive products and for research and development of new technologies. Since World War II there has been a chronic shortage of affordable long-term capital for small- and medium-sized companies in the United States. This shortage has been especially acute lately, as the various regulatory and economic forces have caused the U.S. financial institutions to become even more risk-averse than they would be normally. In conjunction with Arthur Andersen's Enterprise Group and the Gallup Organization, NSBU conducted a survey of the small business community during the summer of 1992, which is somewhat illustrative of the problem. The survey showed that almost half of small businesses had tried to get a loan in the previous year; one in four were denied. Of the business owners with loans, 45 percent reported either a decrease in their banker's willingness to lend or unfavorable changes in their loan terms. So, again, the work of the Committee is most timely and appropriate.

General Comments on Small Business Financing

The Nation's community of small businesses, now numbering almost 20 million, is unique in the world, in its size, its makeup and its vitality (with respect to business formations and failures, the risks taken, and the productivity and innovation exhibited year after year). Indeed, even if the industrialized world forms the triad of multi-trillion dollar economic blocs as predicted by experts, the U.S. will have one "ace" that neither Europe nor Japan have: a dynamic small business community that is the "engine" of job growth. Only China, in my experience, seems to exhibit the culture of inherent entrepreneurism we see in the U.S., but it lacks the political structure needed to fully exploit it.

However, the very size and diversity of the small business community challenges public policymakers when they seek to address one or another facet of small businesses' needs. This is especially true in finance, as the types, amounts, frequency and even the form of financial requirements vary widely within the sector. Of the country's 20 million small firms:

- About 15 million are unincorporated companies, proprietorships and the like; and
- About 5 million have at least one full-time employee and range up to 500 employees.

The first group have a high birth/death rate, are usually financed initially with owner/proprietor capital and derive operating capital from ongoing profit/cash flow, supplemented by micro-loans, either from local banks or individual credit cards.

The second group contains within it companies with a broad variety of business plans, cultures and owner aspirations regarding expected financial payback:

- Some are "lifestyle" companies in which the owners derive financial payback on a year-to-year basis from the cash flows generated by the firms. Usually these are relatively closely-held companies and rely on bank financing to supplement the company profits. Generally there is little interest in utilizing equity as a fund-raising asset (except as security for loans); even if there were interest by the owners, there would be little interest by outside investors except as an acquisition. Most of these firms are kept within a family or are sold to another entity (or the employees) when the owners want to cash out.
- The others are, to one degree or another, growth companies where the owners intend to realize their financial payback via the increased valuation of the company stock. Owner liquidity is derived either from public offerings and/or sale of the business; less frequently (in the U.S.) dividends provide added ongoing shareholder return. These firms can be of interest to outside investors, public or private. Public investors derive payback via increased share values and dividends. Private investors expect their paybacks via increased share valuation and, in some cases, payouts due preferred stockholders; their liquidity is derived from various "exit" schemes, including public offerings, sale of the company and ESOPs, among others.

It is important to review these small business characteristics because the types of financing mechanisms available to small enterprises vary with their operating goals, characteristics and owner aspirations.

For this reason, Mr. Chairman, financing of small business must be looked upon as a *mosaic* with many facets, not a monolithic problem to be solved with a single panacea or "silver bullet." The two bills which are the subject of today's hearing

show this understanding on the part of the Committee, so I would like to briefly comment on each.

"Small Business Incentive Act of 1993"

It is a sad commentary on the state of affairs, but in my view, and with the usual caveat for exceptions, the classic private venture capital industry in this country has essentially withdrawn from the small business sector. They have become risk averse and economically driven to larger and larger (and surer) deals. Thirty-five venture capital houses refused to consider my company's spin-off venture this past year because, at $4 to $6 million, it was "too small." Mr. Chairman, *when a $5 million deal is "too small," you are out of the small business business.* Fortunately, it appears that foreign capital will be able to meet our needs, but too few small businesses have explored the potential of foreign capital.

This is mentioned merely to point out the growing importance of the financing vehicles such as BIDCO's, BDC's, SBIC's and the like, in providing needed affordable long-term capital to small businesses. In the context of the funding mosaic, these vehicles are able to supply funds to those types of businesses that need the money, and at costs which they can afford/are willing to sacrifice.

Therefore, the thrusts of the "Small Business Incentive Act of 1993" are right on the mark. I'll leave it to those more familiar with the technical aspects of the Act to argue the appropriateness of the specific limits, etc., but it's clear that the Securities and Exchange Commission and the Committee are on the right track. The key is to provide more freedom of action and flexibility while preserving the "quality" aspects of the investment process. It seems to me that the draft bill does this.

"Small Business Loan Securitization and Secondary Market Enhancement Act of 1993"

Whereas the "Small Business Incentive Act" is aimed at that segment of the small business community wherein equities come into play, this Market Enhancement Act addresses an even broader range of small firms' needs. Bank financing is critical to all growth companies and many lifestyle firms, so this is probably the single most important niche of the financing mosaic. NSBU's survey shows that the vast majority of small businesses look to banks to provide most of their (long-term and short-term) capital needs. By creating a solid secondary market for small business loans, the Act would improve the flow of available funds which banks could make available to smaller firms.

Currently, the mood of banks is such that making business loans is a less attractive risk/reward proposition than investing in U.S. securities. So, it isn't so much the total amount of money available that is the problem, but the combination of regulatory pressures on banks and levels of U.S. government borrowing that combine to limit availability to small businesses (who, of course, are perceived to be riskier than bigger firms, despite the 2 percent default rate reported in 1992 by the Small Business Administration with its $22 billion portfolio).

By removing regulatory bars to small business loan securitization, this Act would lower the perceived risk at the banking level and encourage loan availability. Again, the overall thrust of this bill is on the mark, and is supported by NSBU wholeheartedly. There are some technical concerns about the specific workings of the bill, but I will leave these to be discussed at more length by Gary Baker in his testimony.

Additional Actions Needed

In suggesting additional actions required in the area of small business financing, Mr. Chairman, I in no way want to diminish the importance of the actions the Committee is already taking in the two bills under discussion here. However, in the context of the "financing mosaic," allow me to suggest some other actions, which may be appropriate for the Committee as a whole, or this Subcommittee:

- One of the niches of financing that has been a difficult one over the years has been long-term financing of life style companies. This arises because the nature of the companies usually precludes interest from venture capital and other such investing groups; yet these firms periodically need long-term loans to improve quality and productivity.

  In the early 1980's, NSBU, led by its member organization in Ohio, the Council of Smaller Enterprises (COSE) in Cleveland, proposed a specific, new funding mechanism to fill this part of the "mosaic," called the Small Business Participating Debenture (SBPD). This was, in essence, a long-term note with characteristics for the investors which looked more like an equity investment (capital gains treatment of interest, for example).

Perhaps it's time to reexamine a mechanism like SBPDs to treat this aspect of financing.

- Last week the Chairman of the Federal Reserve recommended a return to "character loans." This was a method of showing his concern for the credit crunch on small businesses. He also, indirectly I think, reflected the fact that the large, money center banks are not really back doing small business loans. In Massachusetts last year, the Danvers Bank, a local bank with $240 million capitalization, did more SBA loans (numerically) than any other bank in the state. It seems reasonable that the Committee should consider moves to provide incentives for large central banks to reenter the small business lending business.
- The current individual loan limitation for most so-called Section 7(a) guaranteed loans through the SBA program is $750,000. Although this was raised from $500,000 not long ago, it still is too low for many companies, especially at a time when the SBA program may be the only practical source of funds for many companies. We would recommend that the limit be significantly raised, perhaps to $1.5 million (with appropriate safeguards) and indexed to inflation, as you have proposed in some features of the "Incentive Act." This may also make the program more attractive to some of the money center banks.

Again, thank you for the opportunity to testify today on this most important small business issue. I'll be happy to answer any questions you might have.

TESTIMONY OF GARY E. BAKER

MARCH 4, 1993

Introduction

Mr. Chairman and Members of the Subcommittee: Good morning. My name is Gary Baker. I am founder and President of Baker Investment Group, a small business and real estate investment firm in Ann Arbor, Michigan since 1980. Among other activities, I was a co-founder and President of Access BIDCO until last year when I left to help form Captec BIDCO, which is in the process of being formed. I am a member of the Board of Trustees of National Small Business United (NSBU) which is the oldest trade association exclusively representing small businesses in this country for over 50 years. NSBU is a volunteer-driven association with over 60,000 small business members in all 50 states.

Thank you for this opportunity to address you on the problems of "access to credit" (debt) and the "access to capital" (equity) for small businesses. I will confine my testimony today to the following topics:

1) Small Business Incentive Act of 1993
2) Small Business Loan Securitization and Secondary Market Enhancement Act of 1993
3) Additional action the Senate Banking Committee should take to address the needs of small businesses seeking access to capital.

Small Business Incentive Act of 1993

The Small Business Incentive Act of 1993 seems to be a step in the right direction, and for this we should all thank you. Recognizing that outdated regulation can, and does, act as an inhibitor to the access of credit is an important first step. This act is fairly technical and in the interest of time, I shall confine my testimony further to *Section 204. Exemption for Business and Industrial Development Corporations* (BIDCOs). This section would automatically exempt BIDCOs from regulation under the Investment Company Act of 1940 under certain conditions, thereby reducing the need to obtain individual exemptions on a case-by-case basis.

An understanding of BIDCOs would be helpful in considering the ramifications of this section. BIDCOs are a new type of financial institution designed to provide access to debt and/or equity financing for small and medium size companies. BIDCOs fill the gap between typical low risk/low return commercial bank lending and high risk/high return venture capital investing.

low risk/low return	medium risk/medium return	high risk/high return
—debt financing	—debt and/or equity financing	—equity financing
—commercial banks	—BIDCOs	—venture capital

Regulatory limitations on commercial bank lending help create the market for BIDCO financing. For debt financing, BIDCOs do not compete directly with conventional commercial bank loans. If a company can get bank financing with reasonable terms and conditions, it will, due to the existing banking relationship and less com-

plicated application process. However, if a loan to a company is viewed as too risky for typical commercial bank lending criteria, a bank may attempt to utilize some outside credit enhancement, such as the Capital Access Program or the SBA 7(a) Guaranteed Loan Program. If a company still can not qualify for one of these programs, then BIDCO financing may be an appropriate option. It might also be possible to increase that company's ability to borrow from banks, if the BIDCO financing was subordinate to the bank's loan. A bank that has an ongoing relationship with a company, may find itself in a situation where it would like to loan the entire amount requested, but is unable to, due to the company's existing debts or its debt/equity ratio. Banks are not allowed the flexibility to charge a high enough interest rate or take an equity position in order to compensate for the higher risks. In this case, BIDCOs could provide the balance of the financing required. Additional equity or BIDCO financing may be a requirement before a bank loan can be obtained. Also, BIDCOs are not interested in establishing a depository relationship with their portfolio companies. Those companies will continue to need a good relationship with a commercial bank.

In the case of Michigan BIDCOs, they are Michigan corporations licensed pursuant to Michigan P.A. 89 of 1986, commonly referred to as the Michigan BIDCO Act. As private for-profit corporations, they are licensed and regulated by the Michigan Financial Institutions Bureau, which is the same agency that regulates state chartered banks, savings and loan associations and credit unions. BIDCOs are subject to examination at any time by the Commissioner of the Financial Institutions Bureau. Such examination is required at least annually. Further, BIDCOs and their officers and directors are subject to the enforcement mechanisms for violation of said Act that include, among other procedures and remedies, the Commissioner of the Financial Institutions Bureau's power to investigate, issue cease and desist orders, hold hearings, remove officers and directors, take possession of the BIDCO's property and business, appoint a conservator and liquidate that BIDCO. The regulatory system administered by the Financial Institutions Bureau is designed to prevent fraud, conflicts of interest, and mismanagement, and to promote competent management, accurate record keeping and appropriate communication with stockholders.

Being subject to the regulatory and enforcement provisions of the Act provides the comfort to:

- Prospective shareholders so as to facilitate equity investments in BIDCOs, and
- Prospective debt sources so as to facilitate borrowing of money by BIDCOs.

And in general, to safeguard the reputation of BIDCOs as a type of financial institution.

This very careful regulation and supervision of BIDCOs could and should supersede the protective intent of the Investment Company Act of 1940. Therefore, there are three restrictions on this automatic exemption as stated in Section 204 that should be reexamined.

First, Section 204 states that BIDCOs will be automatically exempt, if they propose to do business primarily in that state. This should be left up to the state that is regulating the BIDCO. While it is true that most, if not all, BIDCOs currently operate within the state where they were formed, this may not always be the case. As specialization creeps into the financing industry, at the same time as state boundaries fade as a realistic barrier to trade, it is very conceivable that specialty BIDCOs will form around certain industries where there is common knowledge and understanding. This is certainly true in the venture capital industry. If a BIDCO can conduct its affairs in such a manner as to snake the state regulatory agency comfortable with its market niche approach, and gains approval to loan money to businesses outside the state, what additional benefit would this proposed law hope to attain? Banks loan outside their state.

Second, Section 204 states that BIDCOs will be automatically exempt, if at least eighty percent of each class of securities being offered must be held by persons who reside, or who have a substantial business presence, in the state where the BIDCO is regulated. While this will probably happen anyway, is this requirement necessary as long as all Blue Sky Laws and other securities regulations are complied with in each state where the securities are being offered, which is what happens currently? Again, the state regulatory agency is very thorough, because it has not only initial, but an on-going regulatory responsibility. Today capital does not stop at a states boundaries for other types of investments. Is this an undue restriction for BIDCOs?

Third Section 204 states that this automatic exemption will be only available to BIDCOs that offered their securities solely to accredited investors or other persons as the Commission may permit. Please look at this requirement again. Maybe this could be modified in such a way as to conform to a typical Regulation D exemption

in the case of an interstate private placement offering. That is—no more than 35 non-accredited investors. BIDCOs typically capitalize at under $10 million, with some capitalizing with less than $2 million. To have over 100 investors, and thereby falling under the current provisions of the Investment Company Act of 1940, the average size ownership interest may be appropriate for certain investors that do not meet the strict definition of an accredited investor. Again, the state regulatory agency would be very interested this aspect of the capitalization process.

This is a good bill that could be better with a few more changes. Those changes are small, but could be important to certain BIDCOs trying to form without going through months of waiting and unnecessary regulatory red-tape at the Federal level, just to be granted an individual exemption anyway. These suggested changes may not even arouse opposition.

Small Business Loan Securitization and Secondary Market Enhancement Act of 1993

The Small Business Loan Securitization and Secondary Market Enhancement Act of 1993 is intended to remove some of the regulatory impediments to small business loan securitization, thus providing new sources of funds for banks making small business loans. If this works, it is a great idea. It is modeled after the Secondary Mortgage Market Enhancement Act of 1984 (SMMEA), which is tremendously successful at increasing the funds available for residential mortgages. However, there are some important differences between mortgages on residential real estate and small business loans.

I am concerned about the *"Law of Unintended Consequences."* Just as Sir Isaac Newton observed—for every action, there is an equal and opposite reaction—for every law there are hidden and unintended side effects. As you know, this is a rule of politics, not physics, but it is just as consistent. I am concerned that this proposed law may very well cause some unintended consequences.

First, mortgages that are sold on the secondary market are "formula driven." That is, they have characteristics similar enough to conform to certain fairly specific requirements that allow them to be pooled with other mortgages and securitized. Many small businesses need access to credit that fall outside of a strict formula that would be necessary in order to sell the loan. This would necessitate the banker writing two loans. One that could be pooled and securitized on the secondary market (with less risk) and one that would be held by the bank (with greater risk). This could mean less collateral for the second loan because it was needed to support the first loan. Also, the second loan and payments on that loan will probably have to be subordinated to the first loan. Currently, the banker writes one loan with a blended risk profile. Under this proposed legislation, does the banker carry a smaller subordinated loan with a higher risk, or does the banker decline making the second loan altogether, thereby reducing the access to credit for that small business customer? Neither position is good public policy. However, a BIDCO loan, which is almost always subordinated anyway, could be substituted for the second (riskier) bank loan without exposure to depository funds.

Second, many banks now use the secondary market as their exclusive residential mortgage program. If a potential customer attempts to obtain a residential mortgage that does not conform to the requirements necessary for the bank to sell it in the secondary market they are turned down. While I don't think this will be a wide spread problem with small business loans, because there will be too many small business loans that would not conform to the necessary criteria, it would be a shame to give even one bank an excuse like that to turn down a small business loan.

Third, under the bill "small business related securities" are securities that are rated as "investment grade." What are the characteristics of loans that are pooled to back these securities? Just how restrictive will the loan covenants have to be? Will there be one national form for small business loans? Could the market, and thereby the loans, be pooled into different risk categories with different interest rates commensurate with the risk? This legislation should not specifically prohibit this from occurring. It would open the market to a wider range of small business loans.

Fourth, and most important, include more than traditional commercial banks as originators of loans. Just as mortgage companies can originate residential mortgages, amend this act to include other regulated non-bank small business lenders as originators of small business loans. The SBA allows for non-bank lenders in its guaranteed loan programs with great success. As in the residential mortgage market and the SBA guaranteed loan program this should actually increase the funds available for small business loans and increase the competition in certain areas for small business loan customers. BIDCOs are an excellent example of such a regulated non-bank small business lender.

Increasing the propensity for providing more small businesses with access to credit is a worthy goal and I commend you for your effort. This can be a very complicated problem, with any solution subject to the "Law of Unintended Consequences." These potential unintended consequences may have already been considered, but to the extent this testimony was helpful I am glad to provide it. This is a good start and with a few adjustments could be good public policy.

Additional Action the Senate Banking Committee Should Take to Address the Needs of Small Businesses Seeking Access to Capital

So far we have been addressing access to credit (debt) for small business, however we all know that it is much more difficult for small businesses to obtain access to capital (equity).

The absolute best way for Congress to increase all types of equity investment in small businesses is to provide a tax credit to any non-owner or non-immediate family member who invests in a small business. (Owners and immediate family members will probably be motivated by other factors to invest in a small business.) I understand this is not revenue neutral in the short-term, therefore it may be more difficult to pass it in today's political environment.

The best way for Congress to increase professional equity investment in small businesses without increased spending or providing tax incentives is to create a national framework (minimum definition) for BIDCOs that are licensed and regulated as BIDCOs by the individual states. This will give them visibility, credibility and minimum consistency. Then create reasons for each state to pass enabling legislation and reasons for professional investors in each state to form BIDCOs, such as, automatically exempt BIDCOs from the Investment Company Act of 1940 and allow them to originate loans that can be pooled and used to back "small business related securities." This will start to look like a cohesive and more comprehensive program to assist small businesses in obtaining access to credit and access to capital.

Conclusion

In conclusion, I hope you found this testimony valuable. These are critical issues for small businesses, so I urge your expeditious consideration. If I can be of any further service, I am available to work with you or your staff. Thank you for this opportunity.

APPENDIX

BIDCO (Business and Industrial Development Corporation)

In order to understand the flexibility afforded a Michigan BIDCO, a discussion of a "typical" BIDCO may be helpful. Michigan BIDCOs are a new type of financial institution designed to provide access to debt and/or equity financing for small and medium size companies. BIDCOs will provide access to capital, filling the gap between typical low risk/low return commercial bank lending and high risk/high return venture capital investing.

Regulatory limitations on commercial bank lending help create the market for BIDCO financing.

low risk/low return	medium risk/medium return	high risk/high return
—debt financing	—debt and/or equity financing	—equity financing
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For debt financing, BIDCOs do not compete directly with conventional commercial bank loans. If a company can get bank financing with reasonable terms and conditions, it will, due to the existing banking relationship and less complicated application process. However, if a loan to a company is viewed as too risky for typical commercial bank lending criteria, a bank may attempt to utilize some outside credit enhancement, such as the Capital Access Program or the SBA 7(a) Guaranteed Loan Program. If a company still can not qualify for one of these programs, then BIDCO financing may be appropriate. It might also be possible to increase that company's ability to borrow from banks, if the BIDCO financing was subordinate to the bank's loan. A bank that has an ongoing relationship with a company, may find itself in a situation where it would like to loan the entire amount requested, but is unable to, due to the company's existing debts or its debt/equity ratio. Banks are not allowed the flexibility to charge a high enough interest rate or take an equity position in order to compensate for the higher risks. In this case, BIDCOs could provide the balance of the financing required. Additional equity or BIDCO financing may be a requirement before a bank loan can be obtained. Also, BIDCOs are not interested

in establishing a depository relationship with their portfolio companies. Those companies will continue to need a good relationship with a commercial bank.

Companies seeking an equity investment find that professional venture capital funds or professional, seasoned private investors generally seek targeted rates of return above 40 percent per annum in the form of huge capital appreciation. These investors usually would not consider an investment in a less rapidly growing firm that might, for example, only offer a solid 18 percent per annum rate of return. In order to achieve those very high returns, companies must have the ability to create liquidity (exit potential) for investors usually through a sale of the company or an initial public offering. Also, venture capital investors usually require substantial input in the management of the company, if not control of the board of directors. Owners and managers of many companies object to this loss of control and sale of their companies to liquidate venture investments.

In the past, companies that were in this medium risk/medium return market position would have to scale back and grow more slowly or find more flexible private investors who wanted to limit their risks, but also required a more reasonable rate of return (usually between 15 percent and 30 percent). These investors were difficult to identify.

Private investors have no way to encourage quality deal flow and consequently either have few opportunities to choose from or are inundated with so many business plans, from companies in all kinds of industries, that it is difficult to spend enough time researching each one. They usually do not have a vast array of experience and expertise organized to assist them in making appropriate investment decisions. However, the most important detriment to individual personal investing in smaller companies is the inability for any one investor to diversify his/her portfolio enough to spread the risk, and still have the technical and management expertise organized to monitor and assist each portfolio company.

Regulation of BIDCOs

Michigan BIDCOs are Michigan corporations licensed pursuant to Michigan P.A. 89 of 1986, commonly referred to as the Michigan BIDCO Act. As private for-profit corporations, they will be licensed and regulated by the Michigan Financial Institutions Bureau, which is the same agency that regulates state chartered banks, savings and loan associations and credit unions. BIDCOs are subject to examination at any time by the Commissioner of the Financial Institutions Bureau. Such examination is required at least annually. Further, BIDCOs and their officers and directors are subject to the enforcement mechanisms for violation of said Act that include, among other procedures and remedies, the Commissioner of the Financial Institutions Bureau's power to investigate, issue cease and desist orders, hold hearings, remove officers and directors, take possession of the BIDCO's property and business, appoint a conservator and liquidate that BIDCO. The regulatory system administered by the Michigan Financial Institutions Bureau is designed to prevent fraud, conflict of interest, and mismanagement, and to promote competent management, accurate record keeping and appropriate communication with stockholders.

Being subject to the regulatory and enforcement provisions of the Act provides the confidence to potential debt sources to leverage the BIDCO's asset base with funds borrowed from other sources, such as insurance companies, pension funds, or other large financial institutions, which in turn increase profits to the BIDCO's stockholders. While a commercial bank can sometimes leverage its equity by up to 15 to 1 due to relatively low-risk loan portfolios, a 3 to 1 leverage is seen as a more practical goal for a typical BIDCO providing both equity and debt financing.

The Act exempts BIDCOs from complying with certain usury statutes, so BIDCOs can charge a higher rate of interest. This allows for flexibility when structuring debt instruments with equity features (kickers). BIDCOs can also provide management assistance through its Officers, Directors, or affiliated professional service providers to help strengthen a weakness in a portfolio company's management team or to provide other types of professional services such as loan packaging. This help could insure the success of the company and the objective of the financing.

The Existing Michigan BIDCOs

There are currently 10 BIDCOs licensed and operating in Michigan. The first one started in 1987, with most becoming operational only within the last few years. Each BIDCO has targeted specific geographical areas and certain industry market segments. The State of Michigan, through the Michigan Strategic Fund, has made an investment in each of the previous BIDCOs. This was done to help get this new industry started quickly. Due to the change in administration and priorities, the State will not make any additional investments. BIDCOs with investment by the State are restricted from doing business outside Michigan while the State is an in-

vestor. The enabling legislation that allows BIDCOs to be formed in Michigan is very flexible and encourages BIDCOs to target the market segment of their choice. Most of the BIDCOs have targeted investment opportunities in the upper end of the typical BIDCO risk/reward spectrum, much closer to venture investing than to commercial bank lending. This is a financing market segment that has been drastically under served in Michigan. Although it has taken more time than some industry observers had predicted to jump start this new industry, it now seems that BIDCOs will establish themselves as a viable source for this type of pseudo-venture investing.

Captec BIDCO

Captec BIDCO is a new BIDCO being formed in Ann Arbor, Michigan by Patrick Beach and Gary Baker. The mission of Captec BIDCO is to become a large non-bank financial institution with a strong asset base and constantly growing profits. This will be accomplished by providing primarily franchise businesses with long term financing at reasonable interest rates that are then guaranteed by the U.S. Government through the Small Business Administration 7(a) Guaranteed Loan Program and sold in the secondary financial market.

Being subject to the regulatory and enforcement provisions of the Michigan BIDCO Act provides the confidence needed for the SBA to approve Captec BIDCO as a qualified non-bank lender of 7(a) guaranteed loans. Unlike other recently formed Michigan based BIDCOs, Captec BIDCO will concentrate on providing financing in the lower range of the typical BIDCO risk/reward spectrum, closer to commercial bank lending than venture capital investing. This is similar to the BIDCOs in California that only provide government guaranteed loans. Also, Captec BIDCO will be able to do business outside Michigan because it will be the first Michigan BIDCO not to have the State of Michigan as an investor.

By concentrating on the franchise industry, Captec BIDCO can take advantage of the expertise, experience and contact base of its affiliate, Captec Financial Group, Inc. (CFG). CFG is an equipment leasing firm that has served as a preferred source of equipment leasing for franchisees of recognized franchisers on a nationwide basis. CFG is constantly identifying opportunities within its existing franchise contact base for long term financing of the purchase and/or construction of real estate that are not being met satisfactorily. Captec BIDCO will contract with CFG, on a contingent basis, to assist in identifying appropriate prospects, completing the initial financial and business analysis and packaging the loan application. CFG will also lend its expertise in loan administration and collection. Thereby, overhead is drastically reduced. The officers of Captec BIDCO will directly supervise and be responsible for all functions and activities.

The officers have diverse and complementary expertise and experience. Collectively, they have substantial direct experience as master franchisees in the fast food and instant printing industries. They have a wide variety of experience in small business financing and management, which will help them analyze prospective companies. In addition, they have expertise in real estate acquisition, development and construction.

The real benefit in becoming a SBA approved non-bank lender is the ability to sell most of each loan in the secondary market, which frees up capital to make more loans. By selling 85 percent of each loan in the secondary market, Captec BIDCO will reduce its risk. It will increase its return by collecting a:

- Loan fee and reimbursement for all direct costs
- Reasonable rate of interest on the portion of the loan retained
- Premium on the portion of the loan sold, if it is sold for more than the face value
- Servicing fee on the portion of the loan sold
- Float on the loan payments from the time they are collected until remitted.

Low overhead and the ability to sell 85 percent of each loan at a premium, allows Captec BIDCO to initially capitalize at $2 million with common stock. Additional capital in the form of debt is forecasted to be necessary starting in 1995, which will be secured by the ever growing asset base. Dividends are forecasted to start in the beginning of the second year and are forecasted to be a percentage of the profits. Its assets and profits are forecasted to grow substantially and will be the foundation of its success.

STATEMENT OF JEFFREY C. WIDEN
PRESIDENT OF TOTAL FOAM

SMALL BUSINESS AND ITS ACCESS TO CAPITAL AS IT RELATES TO
THE SMALL BUSINESS INCENTIVE ACT OF 1993

Good Morning! My name is Jeffrey Widen, and I am president and founder of a small business based in Bridgeport, Connecticut known as TOTAL FOAM. Prior to TOTAL FOAM, I had started two other companies in the foam packaging industry, and in both cases, we had trouble with long-term financing I had to sell one because I lacked the financing to expand. Both of these companies are very successful today, one has sales in excess of 100 million dollars annually, and the other moved out of state (with its 135 jobs).

With TOTAL FOAM, we have patented a unique foam packaging system that is ideally suited for packaging of anything from electronics and computers, to glassware and statuary. I started TOTAL FOAM in 1987, and invested approximately $450,000 of my own money with lots of long hours and the standard quotient of blood, sweat, and tears.

During my first year with TOTAL FOAM, I explored every avenue of financing from banks to venture capital groups. I searched high and low for financing, and even with a excellent track record for new business start up, I had no success anywhere in the Northeast. An initial call or visit to a bank was usually the extent of their interest, and usually they didn't even return my phone call.

After about a year and a half, I had spent most of my personal funds on engineering, product development, and field evaluations; and quite honestly I was getting very concerned about the company's future.

In late 1988, I was introduced to Allied Capital Corporation, which is a business development company located here in Washington, DC. With the support of Mr. David Gladstone, who is with us today, we were able to raise the financing to really get the company going, and finish product development and get our marketing off the ground. To date, they have invested more than 2 million dollars into TOTAL FOAM.

We have continued to make the rounds of Connecticut banks, and at last count we have talked to a dozen or so about a business loan with no success. We stated that we were willing to do the paper work for a SBA loan, which is 90 percent guaranteed by the full faith and credit of the U.S. government, but the banks basically discouraged us from this course.

At this point in time, we still have no line of credit from any bank although, sales are increasing every month with sales of $160,000 in January. We are on track to achieve sales of $50 million within five years. We, however, need additional financing to achieve these goals.

While my situation may be somewhat unique, I can only tell you that when I talk to other entrepreneurs and small businessmen in Connecticut, they tell me that, "indeed the banks are not making any loans."

I am sure that somewhere, some small business is getting a bank loan as we speak, and I imagine that some banks are actively loaning money to this market place. There, however, is an excruciating shortage of financing available in Connecticut, and especially in the Bridgeport area.

It's really a shame because, it is the small business man that is creating the jobs (we employ 25 people) that everyone says is no importance for our national economy, and we can't get the financing I believe *50 percent* of all U.S. workers are employed by small businesses. There's money for corporate take-overs (where jobs and businesses are jeopardized) but there is no money for job creating small businesses.

I am sure that banks are much less comfortable in ascertaining the worth of a small business as compared to loaning money for a car, or a condominium development, but there has got to be more financing available for small businesses.

The small business incentive act, and the secondary market enhancement act may be just what the banker needs as it reduces his risks, as he can pool and sell his small business loans to investors. The banker gets nervous in trying to evaluate something that he can't look up in the blue book or repossess.

I don't know exactly what I can say to your committee, Senator Dodd, to emphasize the small business crises, but I do believe that the proposed legislation will help. I don't know exactly how you are going to make the banks be more aggressive, but I do know, however, that without Allied Capital, TOTAL FOAM would not be in existence today.

I believe in Allied Capital and the business development company concept. These type companies seem much more at ease with small businesses, and if these development companies can be stimulated to create more loans, this might be the answer

you're looking for. Also, if more BDC's could be created, this would be very helpful for small businesses, and for the United States economic growth in general.

Senator Dodd, I hope your committee will lend a sympathetic ear to the small business man, and to legislation that would encourage business development companies to continue to grow and prosper.

I appreciate the opportunity to speak with this committee today, and thank you for your time and efforts in helping the small business community.

STATEMENT OF DAVID GLADSTONE

PRESIDENT OF ALLIED CAPITAL REPRESENTING

THE NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES AND

THE NATIONAL ASSOCIATION OF BUSINESS DEVELOPMENT COMPANIES

I. SUMMARY

Allied Capital, National Association of Small Business Investment Companies and The National Association of Business Development Companies all appreciate the opportunity to express their views on the proposed legislation titled, "The Small Business Incentive Act of 1993," developed originally in 1992 by the Security and Exchange Commission ("SEC") and having been changed and amended since 1992. We want the Senate to know that we strongly support the underlying objectives of this legislation which is designed to promote capital formation for small business. We know from our experience that small businesses are the cornerstone of the U.S. economy and their growth and prosperity generates most of the new jobs created in the United States. We also understand that access to financing in the securities market as well as through banks and other third party lenders can be enhanced by reducing regulatory burdens.

II. BACKGROUND ON ALLIED CAPITAL

Allied Capital Corporation and its sister company Allied Capital Corporation II are two of the few Business Development Companies (BDC's)[1] in existence today. The two companies are regulated by the Securities and Exchange Commission (SEC) and you should also know that both Allied I and Allied II each have as wholly owned subsidiaries Small Business Investment Companies (SBIC's) which are licensed and regulated by the U.S. Small Business Administration. These companies are chartered and licensed only to make small business loans and investments and have no other reason for being in existence. Both of these companies are traded on NASDAQ and both are well received by the public as publicly traded companies that help small business.

III. COMMENTS ON THE CURRENT "CREDIT CRUNCH"

In 1974–75 when I was making loans to small businesses, credit availability was terrible. There were no loans available. In 1981–82 when interest rates were sky high, credit for small business was non-existent. Both periods were tough times for small business. But both the BOD periods pale by comparison to the credit shrinkage of 1991–93. There is almost no credit available to small business today. The landscape for credit is a wasteland. Businesses are starving for funds.

WHAT IS CAUSING THIS "CREDIT CRUNCH"?

There are several items one can point to. In my opinion banks are not lending because of regulations and litigation. There are too few non-bank lenders.

1. Regulation is Killing Bank Loans

The regulators have imposed so many conditions on a banks new loans that it stops all loans. I sit on the board of a Bank and if that bank followed everything the regulators proposed, the Bank could not make a new loan. In short, the bank regulators have regulated small business loans out of existence. What loan officer wants to stand before a board of directors of a bank and answer to a regulator who tells the board that the loans office is not in compliance with the regulations. Even though the regulation is one that says he didn't get the real estate appraisal within 30 days of dispersing funds. Or what loan officer wants to be accused by the bank regulators of "relying too much on character" to make a loan!

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[1] BDC's were created to be separate and apart from mutual funds by the Small Business Incentive Act of 1980 ("1980 Act") [Pub.L. No. 96–477], as a category of venture capital companies subject to separate and distinct provisions of the 1940 Act designed to recognize their distinct characteristics. A BDC is a special closed-end management investment company with securities requested under Section 12 of the Securities Act of 1934, and is operated for the sole purpose of making specific types of investments to small businesses.

No loan officer, who has a spouse and children, who depend on the paycheck, will risk their job to make such a loan.

2. Litigation is Destroying Lending

Litigation is a way of life for every loan officer in America today. This sweeping statement is the literal truth. Every loan officer who has been making loans since the eighties has been involved in litigation because borrowers now sue the banks they borrow money from, making outrageous claims against the banks; all in lieu of repaying their debts to the bank. This has left loan officers in a "shell shocked" state of mind, and unwilling to make new loans for fear of creating another frivolous lawsuit. An entire generation of loan officers have been demoralized and negatively trained *not* to make loans.

Loan officers cannot function in today's legal climate because lending is predicted on the "good faith" of the borrower. There can be no good faith relationships when one party (the banker) is always "looking over his shoulder" for a possible lawsuit.

The astronomical number of lawsuits exist today because lawyers can file frivolous lawsuits with *no* consequence to their client or themselves. This litigious climate has shut down lending by thousands of loan officers. As long as lawyers are permitted to make frivolous claims in court in hope that a jury will believe at least some of the claims and make an award of something to them, then, loan officers will not lend. The point here is that if the jury doesn't side with the plaintiff then its no big loss to the law firm.

Congress must pass a law that will allow defendants to recover from plaintiffs all legal and out of pocket expenses, if the plaintiffs lose their suit. It's the only law that will restore order to the lending marketplace. Every civilized Nation in the world has this rule except the United States. We need this law in order to turn the flow of funds back on to small businesses. I beg you to consider legislation in this area.

3. There Are Too Few Non-Bank Lenders

Currently there are too few institutions that will lend money to small businesses when banks are not in business of making those loans. As we know banks are out of the business of making all but a few small business loans. This has caused the current credit crunch. One solution to alleviating the need for capital and small businesses is to help Business Development Companies and Small Business Investment Companies grow by eliminating the regulations that currently keeps them from making loans and investments to small businesses and raising money in the stock market. By eliminating the regulations that currently hamper Business Development Companies the United States Government is making it impossible for additional financial institutions to grow and prosper. These new institutions could be the institutions that will make loans and investments to small businesses. We think that the new proposed law entitled, "The Small Business Incentive Act of 1993," will take a giant step in the direction of encouraging non-bank financial institutions to come forward and since these institutions are for making loans to small businesses it will help the marketplace by providing credit. While all the provisions of the act are not as liberal as they could be, the law is a step in the right direction and we urge that the Senate go forward with this law.

IV. SPECIFIC COMMENTS ON THE PROPOSED BILL

1. BDC's should not be required to make available significant managerial assistance in all instances.

WHAT CRITICS SAY

Section 207 of the bill would amend Section 2(a)(48) to provide that BDC's are not required to make available significant managerial assistance to any company that falls within the new category of eligible companies in which BDC's may invest (i.e. companies which do not have total assets in excess of $4 million and capital and surplus in excess of $2 million). We understand that some people have concern that this change will have the effect of transforming BDC's into the functional equivalent of traditional investment companies yet exempt them from some of the provisions of the 1940 Act ("The Act"). What is believed by some critics of this provision of the bill, is that the requirement that BDC's provide managerial assistance was a critical factor in Congress' determination that it was appropriate to relieve these entities from many of the regulatory requirements under the Investment Company Act. These critics believe that if BDC's were exempt from this requirement to provide managerial assistance, the BDC would more closely resemble traditional investment companies rather than venture capital funds and therefore there would no longer be any reason to continue to exempt them from any of the Investment Company Acts' investor protection provisions. Moreover, the critics say even under the

current managerial assistance requirements shares of an issuing small business company for which a BDC does not provide significant managerial assistance can be purchased and placed in the 30 percent "basket" that a BDC has available for non-qualified securities. Accordingly, the critics maintain there is no need to relax the managerial assistance requirement as proposed in Section 207 of the new bill.

OUR POSITION

It should be noted that the reason for removing the requirement that BDC's provide managerial assistance to the smallest of small businesses was an endeavor to create larger business development companies that would invest in very small businesses. Very small businesses are not being invested in today by most mutual funds. We think this idea in the new law has tremendous merit and could create some very large business development companies that would invest only in very small issuers. We would ask that Congress continue its drive to remove government regulation from the capital flow so that very small businesses can tap the large capital marketplace. For example, if a large business development company could be created which did not have to offer managerial assistance, small public companies could reap the benefit and, indeed, companies that are not public could achieve public status easier knowing that business development companies (rather than individuals) would be there to buy their securities. We think relaxing the requirement for providing managerial assistance to very small companies is an excellent way to remove current regulatory provisions that impedes capital to small business. We urge the Senate to continue this provision of the bill.

We believe that it is quite important for the SEC to exempt BDC's from making available significant managerial assistance with respect to the new company that is described in 55(a)(7) which is described in section 206 of the new bill. We believe this is important because it will free up the BDC's to make available financing to these lesser known, smaller, publicly-traded companies. It should also be noted that Section 207 contains the provision giving the SEC a great deal of power to make changes and close down the operation at any time it felt the public policy was not being well served because the language in the proposed bill says, "or with respect to any other company that meets such criteria as the commission made by rule regulation or order permit as consistent with public interest and protection of investors." So the SEC has the autonomy to make policy decisions and stop the exemptions.

We believe this provision will protect investors and therefore we think Section 207 is a critical part of the legislation and should remain.

2. BDC's should be permitted to purchase shares from third parties per section 208 of the proposed bill.

WHAT CRITICS SAY

At section 208, the new bill would amend Section 55 of the Investment Company Act to permit business development companies to acquire the securities of eligible portfolio companies (as defined in Section 2(a)(46) of the Act) from persons other than the issuer or its affiliated persons which a BDC is currently required to do. Critics maintain that allowing BDC's to purchase securities in the secondary market could have the effect of transforming such entities into passive investment pools, in effect, the functional equivalent of "small cap" investment companies, yet exempt them from many of the investor protection regulations applicable to the latter. This result, critics say, would be contrary to the 1980 Small Business Security Act Amendments, which were premised on the fact that BDC's are fundamentally different from traditional investment companies and that, among other things, BDC's are formed primarily to aid small businesses by furnishing them with venture capital. Moreover, critics say, allowing BDC's to purchase shares in the secondary market would fail to further the stated goals of this legislation since there would not be any additional capital provided to the issuer.

While acknowledging that the secondary purchases by BDC's of securities issues by small companies may have the effect of increasing the liquidity of those securities, critics believe there are other means available for accomplishing this goal. Critics note that one step has already been taken by the Commissions, that is, increasing the amount of non-liquid securities that can be held by an open-end investment company from 10 percent to 15 percent as set forth in SEC Release 33–6927, IC–18612 (March 12, 1992). Critics believe that the current exemption from the provisions of the Investment Companies Act which BDC's enjoy can only be justified from an investor protection standpoint with the BDC performing its designated role of providing funds only to smaller companies.

OUR POSITION

We take strong exception to the criticism that the proposed law would allow BDC's to become "functional equivalents of small cap, investment companies." Nothing could be further from the truth. Because at Section 55(a)(1) it clearly states "securities purchased in transactions not involving any public offering." This clearly limits the Business Development Company from purchasing shares in the stock market. What Section 208 does, is to allow a BDC to purchase from a third party in a transaction not involving a public offering, shares of those businesses or debts of those businesses. Therefore a Business Development Company could buy a note from a bank that was held by a small business or a note from Resolution Trust that was a small business note. Currently, a BDC can't buy these securities from any third party. They must buy directly from the small business. This limits the ability of the Business Development Company to help a small business and indeed to buy attractive securities from non-public sources such as: banks, S&L's, Resolution Trust, FDIC, selling shareholders, selling individuals that are not affiliated with a company.

Nothing in Section 208 of the new bill would allow a BDC to become the functional equivalent of a small cap stock because the BDC can't purchase any securities in "transactions involving a public offering" which includes the stock market. The critics here have missed the boat entirely. What we are talking about in Section 208 is the ability of a BDC to buy from third parties *not* involved in any public offering. We think this is the point that was missed by critics. Therefore in order to increase the availability of capital and liquidity for small business issuers in non-public transactions it is vital that Congress amend Section 55 as set forth in the new law, to permit purchases from third parties by Business Development Companies. We hope the Senate will do this.

It should be noticed also that the SEC has the ability per the legislation to redefine securities purchase in transaction not involving public offerings by the very fact that at 55(a)(1) it says that "in such other transactions as the commission may by rule prescribe if it finds that enforcement of the title of the Securities Act since 1933 with respect to such transaction is not necessary in the public interest" so therefore the commission can make determinations if it believes that somehow the door has been opened too wide.

We would also like to emphasize that according to the proposed regulations the SEC has powers to prevent abuse, by the fact that the law says "subject to such rules and regulations as a commission may prescribe as necessary appropriate for the public interest or for protection of investors."

Both of these paragraphs empower the SEC to close down the operation of BDC's if they want to preclude BDC's from activities that they deem to be wrong or hurtful in some way to public policy. We believe its time to open the door to capital for small business, and let the SEC make these decisions on future problems.

3. BDC's should have a definition of small business but it should be the SBA's definition not the new definitions proposed by the SEC.

At Section 206, the SEC has invented a new definition of small businesses that is different than the one established by the U.S. Small Business Administration ("SBA"). We have two standards: one for Small Business Investment Companies ("SBIC's"), per SBA regulations, can invest in companies with a net worth less than $6,000,000 and after tax profits of less than $2,000,000, and a second standard for BDC's according to the new rule by the SEC. That is, ones with a net worth less than $2,000,000 and assets of less than $4,000,000.

As an alternative to the use of two conflicting definitions of small business, we would strongly urge the Committee to adopt the size standard of the U.S. Small Business Administration for investments in small businesses by SBICs.

To accomplish this, Section 206 of the bill would be modified at line 15 as follows:

> "(iii) it qualifies under the size standard established by the Small Business Administration for financial assistance from Small Business Investment Companies under the Small Business Investment Act of 1958, and regulations promulgated thereunder, or"

4. BDC's should be permitted to grow through borrowings.

Section 209 on capital structure is a critical section for BDC's and growth. Without it there will be no BDC industry but only a few companies like Allied Capital, continuing to plow the fields of small business lending. With Section 209 of the new law, BDC's can grow to be an industry.

These provisions as set forth in Section 209, are provisions that are long and convoluted and were worked out in many long days of discussions between the Association and the SEC. While it is much more convoluted then the simple approach we proposed to the Senate in previous testimony, in the spirit of compromise, we have agreed with the SEC that this is the best for all concerned. We don't understand

all of the "bogeyman" that the SEC is desiring to prevent from coming into the Business Development Company business, but we do accept that they do need to have strong controls over the capital structure of the Business Development Companies. That is why we are strongly in favor of Section 209 and urge the Senate to make this part of the new bill.

5. The Proposed Act will expand the SBIC program as a source of capital for small business.

Small Business Investment Companies (SBIC's) are licensed by the U.S. Small Business Administration and can only make loans and investments to small businesses. We believe the Bill's passage in its current form could usher in a new era of publicly held SBIC's that are exempt from the 40 Act. Sections 201, 202, 203, and 205 of the bill are extremely helpful to SBICs. Combining that with the new participating securities form of leverage just put on the books by the SBA could be one of the most powerful inducements to capital to make loans and investments in small businesses. We want to commend the committee for introducing these changes and believe it will be a boom to a new generation of sources of risk capital for small growth firms.

CONCLUSION

With only minor changes we suggest that the Senate should pass the proposed law entitled, "The Small Business Incentive Act of 1993." Even if the changes suggested are not made the Senate should pass the proposed law because it will do so much good in our economy today. It will help small business investment companies to lend more. It will help business development companies provide capital to small businesses. And out of all this it may develop (over the next ten years) a group of lenders and investors specifically oriented toward helping all of our small businesses. And most importantly this new BDC industry can be based in raising money on the U.S. Stock Market as opposed to depositors and other government supported programs. We think that these changes will be magnified ten-fold within the U.S. economy and help us all grow our way out of what can only be described as a terrible situation today. We need your help. We ask that you pass this law as quickly as possible and pledge the support of the National Association of the Small Business Investment Companies and the National Association of Business Development Companies to helping you champion this law through the Senate and the House and onto the President's desk.

STATEMENT OF THE NATIONAL VENTURE CAPITAL ASSOCIATION

MARCH 4, 1993

Introduction

The National Venture Capital Association ("NVCA") is an organization which represents over 200 venture capitalists nationwide. These venture capitalists were responsible for investing over one billion dollars last year in small businesses. In many ways we comprise the backbone of high growth small businesses. Indeed the computer, computer peripherals, and semi-conductor industries were all small businesses at one time and were started almost entirely through investments by venture capital funds.

I. CAPITAL RAISING PROBLEMS OF SMALL BUSINESSES

Your kind invitation to testify here today asked that the witnesses address, in general, the current problems facing small businesses seeking to raise capital and the witnesses' views on the reasons for those problems. Obviously, the membership of the National Venture Capital Association is vitally interested in such problems. Our membership, consisting as it does of virtually all of the private and public venture funds in the country, deals with these problems on a daily basis.

Recently, however, the country has experienced for the first time a sustained decline in the amount of venture capital available. Some of this decline is, of course, due to changed (*i.e.*, increased) risk perceptions. Much of the decline, however, can be traced directly to the increased capital gains tax burden in place since 1986 and certain regulatory burdens which have restricted the flow of public venture capital.

To be sure, small business will always have problems raising capital. Investing in small business entails a high degree of risk. The much ballyhooed banking "credit crunch" is nothing new to small business. Small businesses are always part of a credit crunch.

My point here is that, for the most part, the capital formation problems that small businesses face must find solutions that are investor based rather than credit based. Short of direct subsidies in the form of low interest government loans or guarantees,

the things that will encourage an investor to invest in a small business, in addition to a reasonable expectation of high return, are liquidity and the ability to diversify. Banks and other traditional sources of debt capital will lend only after substantial revenues have begun to flow and, generally, the company owns sufficient hard assets as collateral. In contrast, equity capital is relatively cheap. That is why it is critical to small businesses that the United States maintain a sufficient flow of venture capital.

A. Liquidity

In general, professional venture capitalists seek to assure the investors in their funds that appropriate exit strategies are available. Almost always, these consist of initial public offerings ("IPO's") or "buyouts" or mergers with existing mature companies. What is missing is a mechanism for trading, between sophisticated, institutional investors, the illiquid securities held by venture capital funds that suddenly find themselves with need for additional capital but nowhere to sell their portfolio even though other venture funds would be willing to purchase them.

This anomaly appears to be an accident of history. The Securities Act of 1933 (the "Securities Act") exempts, in section 4(2) "transactions by an *issuer* not involving any public offering." (Emphasis added.) Section 4(2) provides, of course, the well-known "private offering" exemption from the registration provisions of the Securities Act. Because Section 4(2) is limited to transactions by an issuer, it does not exempt resales by purchasers, who themselves qualified for the private offering exemption as a sophisticated investor. These sophisticated purchasers do not have the benefit of the Section 4(2) exemption to resell the securities to other sophisticated purchasers, even though, had the second group of sophisticated purchasers approached the issuer, a sale to them would have been exempt.

The exemption is, thus, "buyer based." That is, it is perfected by qualifying the buyer as a person who can "fend for himself" or is "sophisticated." There would appear to be no difference between the need to protect the first or the second purchaser. Indeed the Commission looked as if it would take this step when it made its original proposal for Rule 144A.

The problem, then, lies in the language of the statute itself. We would urge the adoption of an amendment to Section 4(2) so that section, as revised, would exempt from the Securities Act's registration provisions "transactions not involving any public offering." This amendment would permit venture funds and, not incidentally, any other purchaser to sell securities purchased in a private offering so long as the sales were made to an appropriate purchaser. It would go a long way toward accomplishing the goals embodied in the SEC's adoption of Rule 144A, the development of a secondary market in securities held by institutions and other sophisticated investors, without unnecessarily relaxing the necessary protection which the prospectus delivery requirements of the Securities Act provide to the investing public.

B. Ability to Diversify

The 1980 "business development company" amendments to the Investment Company Act of 1940 (the "1940 Act") were certainly a well-intentioned effort to provide an additional, public, venture financing vehicle. Unfortunately those amendments were so complex and difficult to administer that few if any of the funds that took advantage, of these provisions have been able to successfully convince the large pools of sophisticated capital, such as pension funds and insurance companies, to invest. Indeed, new investment in the venture capital industry by institutional investors has declined in recent years from $4 billion in 1986 to about $1 billion in 1991. While the NVCA believes that the failure to enact favorable capital gains legislation is the primary reason for this decline, we also agree with the assessment of one venture capitalist that:

> among the factors contributing to this decline to the level [of institutional investment] in 1980 are the returns achieved by other investment asset classes, the illiquidity of venture capital partnerships and the complexity of the partnership structure (as it has been developed and refined by pension fund advisory "gatekeepers" to protect their clients as limited partners).[1]

Making public venture capital funds realize their promise also has advantages for retail investors. Currently smaller investors have very little opportunity to invest in emerging growth companies during the earlier stages of their growth. Such opportunities as they do have often involve extremely risky, illiquid investments in single issuers; and they have little practical means of monitoring the investment. Public venture capital funds would permit retail investors to invest in (1) diversified port-

[1] See Letter from Joe D. Tippens, Vice President, Merrill Lynch Venture Capital Inc. to Marianne Smythe, Director, SEC Division of Investment Management (Feb. 4, 1992).

folios of (2) companies selected by professional venture capitalists (3) who will carefully monitor the portfolio companies and provide them management assistance and (4) with the liquidity provided by a public market.

We also agree with the statement of the National Association of Small Business Investment Companies that "the BDC amendments to the [Investment Company Act of 1940] should be treated as the first phase of an experiment to establish a separate regulatory scheme under the 1940 Act for pooled investment vehicles that serve to provide capital to small businesses. . . ."[2] We would think that if this Subcommittee wished to take a truly bold step toward advancing capital formation in this country that NASBIC's suggestion would be an excellent place to begin.

With those as "global" comments, we turn now to the specific legislative proposals. We have not commented on all of the proposals but have attempted to limit ourselves to those which have particular relevance to the professional venture capital community.

II. The Small Business Incentive Act of 1993

A. Amendments to The Investment Company Act of 1940

1. *Creation of New "Qualified Purchaser" Exception*

The Commission has recommended the relaxation of the "99 investor" test in 1940 Act Section 3(c)(1) through the creation of a new "qualified purchaser" exception. This exception, the analogue of the "accredited investor" concept now part of the Securities Act (and the Commissions' Regulation D), would add section 3(c)(7) to the 1940 Act, and except from the definition of investment company any issuer all of whose security holders meet objective standards of financial sophistication.[3]

We favor this concept at least as a starting point toward encouraging institutional investors to invest in larger pools of managed capital. We question, however, the need for exclusivity of qualified purchasers in the proposed legislation. In our view, there ought to be some flexibility in the concept and we thus suggest that a 60 or 65 percent threshold would be more appropriate. To the extent that non-qualified purchasers were to purchase the securities of the contemplated investment vehicle, we believe the presence of an overwhelming majority of sophisticated institutional investors would serve as a barrier to any concerns regarding the need for protection of those investors.

2. *Section 61(a)(1)—Reduce Asset Coverage Requirements for BDC's*

The proposed legislation would amend Section 61(a) of the 1940 Act to permit business development companies to become more highly leveraged. Currently, Section 61(a) requires 200 percent asset coverage for the issuance of senior debt securities by business development companies. The proposed legislation would amend Section 61(a) to reduce this asset coverage requirement to 110 percent provided that two conditions are met. With the lower asset coverage requirements, business development companies would be able to raise more funds. This, in turn, would increase the amount of money that the BDCs would have to invest in small businesses. The NVCA supports this amendment.

3. *Section 61(a)(2)—Permit BDC's to Issue Multiple Classes of Debt*

The proposed legislation would amend section 61(a)(2) to permit a business development company to issue, without restriction, multiple classes of debt. We concur with NASBIC's suggestion to the SEC that this restriction against public borrowing by BDC's be eliminated to put BDC's in the same position as other public financial institutions.[4] No one is quite sure why this restriction was included in the 1981 legislation and, at present, there seems little reason not to let market discipline be the regulator of whether a BDC should issue debt securities.

4. *Section 61(a)(3)(A)—Permit BDC's to Issue Senior Debt Accompanied by Warrants, Options, or Rights to Convert*

Section 61(a)(3)(A) as it is currently written forbids BDC's from issuing senior debt securities "accompanied by warrants, options or rights to subscribe or convert to voting securities" of a BDC. As with section 61(a)(2), discussed above, the legislative history of this provision is silent. We would like to take the opportunity to applaud in particular proposed Section 209 of the Small Business Incentive Act of

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[2] See Letter from Peter F. McNeish, President, National Association of Small Business Investment Companies to Marianne Smythe, Director, SEC Division of Investment Management (January 27, 1992).

[3] "Qualified purchaser" would be defined, in a new section 2(a)(51), as whomever the Commission, by rule, decides.

[4] *See* note 2, *supra.*

1993 which, as stated above, amends Section 61(a)(2) of the 1940 Act to permit a BDC to issue, without restriction, more than one class of debt securities, and which amends Section 61(a)(3)(A) to permit a BDC to issue warrants, options, or rights to subscribe or convert to voting securities, under certain conditions, either alone or accompanied by debt or other securities. Adopting this provision would provide greater financing flexibility to BDC's and increase the number of investment strategies available to them.

B. Proposal to Amend the Securities Act

The NVCA supports the proposal to expand the SEC's exemptive authority under Section 3(b) of the Securities Act. Currently, under Section 3(b), the SEC may exempt through regulation offerings up to $5 million. Section 3(b) has served as the statutory basis for the exemptions under Rules 504 and 505 of Regulation D and under Regulation A. The proposed legislation would increase the exemptive authority under Section 3(b) to offerings of up to $10 million. NVCA believes that this amount could be increased to $15 million without compromising investor protection.

III. Additional Actions Needed to Assist Small Business Capital Raising Efforts

This section of our statement addresses several areas of concern, some of which are directly relevant to the Commission's proposed legislation and some of which are not.

A. Amend Section 63 of the 1940 Act To Permit BDC's To Sell Common Stock Below Net Asset Value

One of the reasons that BDC's have not proved a more popular vehicle is that they have generally attempted to raise all or most of their capital in a single public offering. A venture fund (public or private) cannot, as a practical matter, invest this money in portfolio companies all at once. First, it takes time to identify suitable investments, and second, the funds generally reserve some money for follow-on financing. Consequently they must, at the beginning, "park" a large portion of their capital in relatively low-yielding money market instruments.

Conventional private venture capital funds avoid this problem by raising capital from institutional investors through subscriptions that provide for a series of payments spread over three or more years. These phased pay-ins are designed to match the rate at which the fund makes its portfolio investments. This structure improves the yield of the fund if its portfolio investments are successful. If BDC's could adopt a similar structure, they would be able to improve their yields and would thus be more attractive to both retail and institutional investors.

There is a structure that would solve this problem. Under this structure, a newly-organized fund would enter into subscription agreements with institutional investors to sell them shares in several installments. The price for the first installment would be fixed. The price for later installments would be the lower of the market price or net asset value at the time of the installment. The fund would then conduct a public offering to raise its initial capital at the price paid by the institutions for the first installment.

Unfortunately, an agreement by a registered closed-end fund (*i.e.*, a public BDC) to sell shares at a fixed price in several installments raises a legal question under the 1940 Act. There would be a possibility that the net asset value of the fund at the time of any given installment would be greater than the subscription price. Section 23(b) of the 1940 Act prohibits sales of shares of a closed-end fund at a price below net asset value. Accordingly, if the "sale" were considered to take place at the time an installment was consummated, there would be a possibility of a violation of Section 23(b).

The original 1980 BDC amendments loosened the restrictions of Section 23(b) for BDC's, but the liberalization was so confined by procedural limitations that it falls short of resolving the issue in a way that would permit BDC's to use the structure suggested above. Section 63(2) of the 1940 Act, which was added by the BDC amendments, permits sales at market price, even if that is below net asset value. It requires, however, that the shareholders approve the "policy and practice of making such sales of securities at the last annual meeting of shareholders . . . within one year immediately prior to any such sale."

Again, there is some ambiguity about the application of this provision, but it can be read to require shareholder approval each year of any issuance of shares at any price below net asset value. As a practical matter, section 63(2) makes it impossible for a BDC to enter into binding subscription agreements to issue shares at the market price. The result is a substantial impediment to venture capital formation because of the continuing reluctance of institutional investors to invest in public venture funds.

We recommend that Congress remove this impediment by a simple amendment to the 1940 Act permitting BDC's to enter into binding subscription agreements providing for issuance over a period of time of shares at the then current market price. This would permit BDC's and institutional investors to make the commitments necessary to permit BDC's to function the way private venture funds operated—thus carrying out the premise of the original BDC amendments and substantially increasing the amount of funds available to smaller businesses.

This one small change in the BDC provisions of the 1940 Act has the potential for creating large new pools of venture capital to be invested in emerging companies. These pools will also have substantial advantages for both retail and institutional investors.

B. Amend Section 205 of the Investment Advisers Act of 1940 to Reformulate the Compensation Provisions

Section 205 of the Investment Advisers Act of 1940 (the "Adviser's Act") provides that an advisory contract between an investment adviser and a BDC may provide for compensation to the adviser based on a share of capital gains upon or capital appreciation of the funds of the BDC if, among other things, the compensation "does not exceed 20 per centum of the realized capital gains upon the funds of the business development company over a specified period or as of definite dates, *computed net of all realized capital losses and unrealized capital depreciation. . . .*" (Emphasis added.)

In its January 27, 1992 letter to the Commission, NASBIC urged a modification to the above-described formula which would permit the factoring in of unrealized capital gain. NASBIC pointed out that the SEC staff has, on occasion, allowed investment company act registration statements to go effective with disclosure that adds the word "net" before the term "unrealized capital depreciation" in the formula, in effect modifying the formula in the Advisers Act.

In addition, and also as pointed out in the NASBIC letter, it is now common practice in the venture industry for venture capital advisers to calculate their performance fees by netting out capital appreciation. We urge the Congress to make this latter formulation explicit in Section 205 so that public venture capital managers are not disadvantaged relative to their private counterparts.

C. Employee Stock Options

A number of organizations, including members of the SEC staff, have been urging a revision in the treatment of accounting for employee stock options. Their view is that stock options are compensation and should in some form be chargeable against the future earnings of a company.

This would have a disastrous effect on the total venture capital industry. The effective use of employee stock options is key to the very high efficiency with which venture backed companies achieve their goals. In many cases every member of a venture backed company will receive stock options, which are a tremendously effective stimulant in keeping the team focussed on the goals of the organization.

An earlier study showed that charging earnings for the "asserted value" of options would have artificially reduced the stated earnings of the companies studied by 40 percent. This would have seriously impacted the ability of those companies for obtaining financing, and would probably have defeated the emergence of a number of major multi-national organizations. The impact of this kind of proposal is not severe for large companies. The effect is most pronounced with very rapid growth, very young companies.

The dilative effect of options is a material factor in evaluating a company. We would suggest that the dilative effect be more prominently displayed in capitalization statements.

D. Plan Asset Regulations

ERISA has imposed a number of bureaucratic burdens on the venture capital industry. When ERISA was first passed for several years no money flowed from pension funds into venture capital funds because of concern about the legality of such risk investments. Subsequently, the Department of Labor regulations provided relief, but continued to impose bureaucratic burdens that still limit the number of pension plan investors. The regulations also create considerable toll in time and legal expense for every new venture fund that accepts money from pension plans.

The process that these procedures control is one that in fact is self-regulating. These burdens provide no meaningful protection to pension plan beneficiaries, yet for years we have not been able to obtain relief. We would propose that ERISA Act be amended to exclude well funded, single employer defined benefit plans from the plan asset regulations.

TESTIMONY OF THOMAS N. RICHMOND, JR.
FIRST VICE PRESIDENT, MCDONALD & COMPANY SECURITIES, INC.

CONCERNING IMPROVING SMALL ISSUERS' ACCESS TO CAPITAL

Summary

I share the Subcommittee's concern about improving small businesses' access to capital. Small business has a critical role to play in our economy by creating new jobs and new products. Helping new businesses find capital is critical to helping our economy grow. I also am certain that Congress and the Securities and Exchange Commission can take these actions without jeopardizing investors and the public.

Both the Small Business Incentive Act of 1993, and the Small Business Loan Securitization and Secondary Market Enhancement Act of 1993 will help achieve these goals.

1. The Small Business Incentive Act of 1993 would raise the ceiling on exempt stock offering to $10 million. Congress has not altered this ceiling since 1980, and should do so to keep pace with inflation.

This legislation also would grant certain exemptions from the Investment Company Act of 1940 to improve the ability of investors to pool funds and invest in small businesses. Current exemptive provisions are too cumbersome or restrictive for effective use. The bill would mitigate these difficulties, such as reducing restrictions on business development companies and allowing the creation of exempt private investment companies. While these exemptions will not solve every problem, they would be a step in the right direction.

2. The Small Business Loan Securitization and Secondary Market Enhancement Act of 1993, S. 384, would facilitate the securitization of small business loans based on the model of the Secondary Mortgage Market Enhancement Act of 1984 ("SMMEA"), which facilitates private securitization of mortgages. This legislation would permit private poolers of small business loans to securitize the assets and sell them to a broad class of investors. While there are significant differences between small business loans and mortgages, this legislation would be extremely useful. Allowing lenders to more easily securitize and sell loans to an enlarged universe of investors would encourage these same lenders to make, in turn, more loans, increasing the flow of funds to small business. It also would provide significant new investment opportunities to the public. I urge Congress to enact this legislation.

3. The Senate approach to solving these capital access problems, that is, facilitating the issuance and trading of small business backed securities by the private sector is, I believe, the correct initial approach. Although the House is considering legislation to create a new Government Sponsored Entity ("GSE"), I would defer taking such action. The private sector, given passage of S. 384, could more efficiently structure such transactions and more quickly bring such securities to market. Congress could then assess the growth and performance of the market and could determine if any legislation is appropriate, including the creation of a GSE.

Introduction

Chairman Dodd, Senator Gramm, and Members of the Subcommittee: I appreciate this opportunity to testify on behalf of McDonald and Company Securities, Inc. regarding the access to capital of small businesses in America today. McDonald is itself, by comparison to the larger institutions in New York, a smaller business, employing roughly 900 people. While we are a full-service brokerage house, our strength since our founding some 70 years ago has traditionally been the relationships we maintain with the generally smaller businesses located within a 500 mile radius of our headquarters in Cleveland.

I personally have been an investment banker for eight years, and I currently specialize in the structuring, pricing, marketing, and trading of publicly offered and privately placed debt and equity securities, generally backed by the assets of smaller partnerships and corporations, and in providing financial analysis to several of McDonald's clients. Prior to joining McDonald, I was involved in all aspects of the primary and secondary mortgage-backed security and collateralized mortgage obligation markets at PaineWebber and Salomon Brothers. I will draw on this background to make comparisons between the development of those markets and the state of the market for securities backed by the credit of small and emerging businesses later in this testimony.

I understand that the Subcommittee is concerned with revitalizing the Nation's economy and with helping small businesses to develop and grow, creating new jobs. Central to that process is assisting small business in obtaining capital for start-up and expansion. This Subcommittee has asked me to comment on two specific legislative proposals to facilitate that process. The first bill is the Small Business Incentive

Act of 1993.[1] This legislation is a refinement of a bill that Chairman Dodd introduced in the last Congress,[2] and now includes some further recommendations of the Securities and Exchange Commission. The second bill is S. 384, the Small Business Loan Securitization and Secondary Market Enhancement Act of 1993.[3]

I hope to assist the Members of the Subcommittee today by offering my views on these bills. I also have a few additional comments regarding other aspects of the process of creating fair and efficient markets for these types of loans.

Overview

In his State of the Union Address, President Clinton stated that the smallest firms in the country, with annual revenues of under $5 million, employ about 40 percent of the workforce. He stated that these firms constitute about 90 percent of the employers in America. These small firms have created a "big majority of the net new jobs for more than a decade." Among other things, the President promised "to attack this credit crunch which has denied small business the credit they need to flourish and prosper."[4]

Entrepreneurs and small businesses are plagued perennially by the problem of raising capital. Big companies, those with proven track records, have always had an easier time raising capital than have small companies. Small companies, with their new and innovative products and services, often produce the stellar growth rates and profitability that investors seek. Large, established companies with mature products rarely achieve such extraordinary results. It is typically the young inventor or entrepreneur, working on his or her kitchen table, using personal savings, money borrowed from relatives, or even credit cards who brings us the innovative companies and products that we all eventually enjoy. Unfortunately, small and start-up companies have a very high casualty rate. Not all new ideas pan out, perhaps because a scientific theory proves wrong, or because a laboratory breakthrough has little practical value. Some new businesses fail because the principals lack basic management skills; some entrepreneurs are better at splicing genes than balancing a check book. As a consequence of these and other reasons, small companies face high capital costs.

It also appears that minority entrepreneurs face disproportionate difficulties in raising capital. *The Wall Street Journal* recently reported that in a Roper Poll of 500 African-American entrepreneurs, 83 percent of those asked believe that raising capital is a very serious problem for black entrepreneurs, and 9 percent believe it is a moderately serious problem. As difficult as it is for all small businesses to raise capital, the problem seems substantially worse for minority-owned business.[5] There may be many reasons for this problem, but clearly it is troubling.

It is undeniable that if more entrepreneurs had the capital to take their ideas from the drawing board to the marketplace, our economy would be stronger. When entrepreneurs cannot obtain capital, it means that new industries and new jobs vanish. How many more Xeroxes, Apple Computers, or Federal Expresses would there be if more small businesses could have obtained financing? How many more Americans would be working and providing exports to other countries? We will never know. But we do have an opportunity to address this problem prospectively for all present and future entrepreneurs.

While Congress should not try to change the underlying risk premium that all small companies face, it can reduce statutory and regulatory obstacles that burden small companies unnecessarily. I am a strong believer in investor protection and in honest markets. A crooked marketplace raises all companies' capital costs, so I do not endorse changes that would potentially eliminate important investor protections. Nonetheless, there are opportunities to reduce regulatory hurdles responsibly to accommodate new financing methods. I believe the two bills before this Subcommittee constitute such responsible efforts.

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[1] This legislation is expected to be introduced by Senator Christopher Dodd (D-CT), Chairman of the Securities Subcommittee, on March 2, 1993. Original co-sponsors for the legislation are expected to include Senator Donald W. Riegle, Jr., (D-MI), Chairman of the Committee on Banking, Housing, and Urban Affairs; and Senator Alfonse M. D'Amato (R-NY), Ranking Republican Member of the Senate Banking Committee.

[2] S. 2518 (102d. Cong., 2d. Sess.).

[3] *See* note 15, *infra.* and accompanying text.

[4] President Bill Clinton, State of the Union Address, February 17, 1993, as reported in *The Washington Post,* Feb. 18, 1993, at A24, col. 2.

[5] Black Entrepreneurship, *The Wall Street Journal,* Feb. 19, 1993, R1 *et seq.*

Legislation

1. Small Business Incentive Act of 1993

I endorse the Small Business Incentive Act of 1993, as providing appropriate relief from some of the strictures of federal securities laws. Some of the provisions in these statutes were intended to address other situations, or did not contemplate newly developed financing arrangements that are prudent and depend on other safeguards. Other efforts to facilitate new investment vehicles may have proved too cautious. I commend the sponsors of this legislation for their efforts and believe that the time has come to move forward with these proposals.

I endorse the proposed amendment of Section 3(b) of the Securities Act of 1933 (the "Securities Act") to increase the size of exempt offerings from $5 million to $10 million. The size of this exemption has not kept pace with inflation; Congress has not increased the dollar limit of Section 3(b) since 1980.[6]

The Commission has used the authority under Section 3(b) and other provisions of the Securities Act to ease capital raising for small issuers. At the same time, I believe the Commission has been sensitive to investor protection concerns. For example, last year the Commission adopted changes to Regulation A[7] to improve its flexibility. Among other things, the Commission increased the size of offerings permitted under Regulation A from $1.5 million to $5 million.[8] In my judgement, this action was clearly a step in the right direction. However, additional coordination with state securities authorities may be required for such initiatives to help small business without jeopardizing investors. I urge the SEC to take the further step of raising the offering ceiling to $10 million, if Congress raises the ceiling in the Securities Act.

The Commission also has liberalized aspects of Regulation D, which permits offerings of different sizes without registration pursuant to Section 5 of the Securities Act.[9] The Commission eased restrictions under Rule 504 for offerings not exceeding $1 million by, among other things, eliminating restrictions on general solicitations and resales.[10]

Legislative and regulatory actions such as these can make a real difference in the ability of companies to raise funds. Start up companies have a hard time finding the funds to pay scientists, buy computers, or lease offices; whenever they must pay lawyers and accountants, the funds come out of what otherwise might have been spent developing or producing products. In this day and age, a $10 million offering is not so large as to justify the substantial expense associated with more elaborate disclosure. Reducing these regulatory burdens hardly leaves investors without any protections.[11] The specific rules for exempted offerings, combined with the general anti-fraud protections of Sections 12 and 17 of the Securities Act, and other provisions, such as Section 10(b) and Rule 10b–5 under the Securities Exchange Act of 1934 (the "Exchange Act") mean real protection for investors. These measures deter fraud in the first instance, and provide meaningful remedies in the event fraud occurs.

I also support the legislative proposals to amend the Investment Company Act of 1940 (the "1940 Act"). I think that liberalizing the 1940 Act holds significant promise for the Commission to improve capital access for small business. The following briefly discusses the major provisions in the legislation and my perception of their practical impact:[12]

(i) Business Development Companies—In 1980, Congress added sections 54–65 of the 1940 Act permitting the creation of business development companies ("BDCs"). Congress intended that these provisions "establish a separate and distinct regulatory scheme for [BDCs] which otherwise might be regulated as investment companies. . . ."[13] BDCs are intended to facilitate pooled investments in small businesses.

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[6] Section 301 of the Small Business Investment Incentive Act of 1980, Pub. L. No. 96–477 increased the dollar amount in Section 3(b) of the Securities Act from $2 million to $5 million. 1 Fed. Sec. L. Rep. (CCH) ¶ 2351.001.

[7] 17 CFR §230.251 *et seq.*

[8] Securities Act Rel. No. 6924, at 3 (notice of proposed rulemaking) ("Proposing Release"), and Securities Act Rel. No. 6949, at 5 (adoption of final rules) ("Adopting Release").

[9] 17 CFR § 230.501 *et seq. See also* 1 Fed. Sec. L. Rep. (CCH) ¶ 2373.

[10] Proposing Release, at 28–29; Adopting Release, at 19.

[11] I also understand that these proposals are intended to be helpful to Small Business Investment Companies ("SBICs"), which are licensed and regulated by the Small Business Administration. The legislation is intended to permit SBICs to make use of the new flexibility for private investment companies, and business development companies, as outlined below.

[12] For a more detailed description of the proposed amendments to the 1940 Act, *see* Attachment II.

[13] H. Rep. 1341, 96th Cong. 2d. Sess. 37, as reprinted in 1980 U.S.C.C.A.N. 4819.

Unfortunately, BDCs have not proven to be a popular alternative for investing in small businesses. Some of these problems resulted from the failure to obtain pass-through tax treatment for BDCs. I understand that this problem was addressed some years ago. Nonetheless, BDCs remain an under-utilized vehicle for small business finance.

This Subcommittee, in cooperation with the SEC and other interested groups have formulated changes to the 1940 Act that would simplify or reduce restrictions on BDCs. These changes make it easier for BDCs to invest, create a larger universe of eligible investments, and give BDCs much greater flexibility with respect to their capital structure. This less rigid framework is balanced by increased reporting requirements which should protect BDC investors.

I endorse this effort to liberalize the regulatory regime for BDCs. In particular, I welcome broadening the types of portfolio companies, and eliminating a current requirement to provide managerial assistance. I also endorse allowing BDCs to issue more categories of debt. While I also endorse the effort to reduce the restrictions on leveraging, I believe the legislation will not be effective. The bill's language is excessively convoluted and elaborate; BDCs will have an extremely difficult time complying with these requirements. As a consequence, the restrictions limit the utility of the whole section. Moreover, some of the added disclosure requirements appear excessive.

(ii) Private Investment Companies ("PICs")—The bill would create a new exception from the registration requirements of the 1940 Act for groups of "qualified purchasers" or sophisticated investors. Unlike the current Section 3(c)1 of the Act, the proposed Section 3(c)7 would, for instance, abolish the current limit for 100 investors in any such PIC and would allow any PIC so controlled to make public offerings. The bill does not impose limitations such as restricting the number of beneficial ownership to 100 persons, or not making a public offering. The bill does not except private investment companies from the certain "pyramiding" requirements of the 1940 Act.

Parenthetically, the bill also contemplates easing the attribution rules relating to the 100 investor limit for all investment companies. This, too, will be a useful tool in helping to raise money for smaller enterprises. This new exemption from the definition is helpful, but may create interpretive problems. For example, the bill states that the outstanding shares must be owned at the time of acquisition exclusively by qualified purchasers. What would be the outcome if one of the purchasers, knowingly or otherwise, did not constitute a qualified purchaser? Would the exception have been void *ab initio?* In addition, the utility of the exception will be small if the Commission's rules for defining a "qualified purchaser" are too rigorous and unavailable for nearly all investors.

(iii) Increase Closed-End Investment Company Exemption—Section 205 of the bill would increase the intrastate exemption for closed-end investment companies. Currently, section 6(d)(1) of the 1940 Act provides an exemption for closed-end companies: (1) if the aggregate sums receive by the company, plus the aggregate offering price of all securities of which the company is the issuer and which it proposes to offer for sale, do not exceed $100,000; (2) the securities are offered to residents of the state under the laws of which the company is organized; and (3) the exemption is in the public interest. The bill would increase the dollar amount from $100,000 to $10,000,000 or such other amount as the Commission may set by rule, regulation, or order.

The amendment to Section 6(d)(1) of the 1940 Act is overdue. Congress has not amended this provision since it was enacted in 1940. Accordingly, the amount of the exemption has been trivialized by the effects of inflation. Although closed-end companies have not been a major vehicle for investment in small businesses, I believe it will be helpful to raise this limit to more realistic amounts. I also endorse giving the Commission rulemaking authority to adjust this figure upward over time.

I also welcome the recent regulatory efforts that the Commission has taken with respect to improving financing opportunities for small businesses. In particular, I welcome Rule 3a–7 under the 1940 Act, which facilitates structured finance.[14] This rule permits businesses to securitize assets under a safe harbor from the 1940 Act. The rule is not a panacea for small companies; unless a proposed securitization fits exactly within the terms of the rule, the issuer may lack the assurance that its transaction complies with the Act. Nonetheless, the rule is a step in the right direction, and I am hopeful that the Commission will consider liberalizing it further in the future.

I appreciate these proposed amendments to the 1940 Act, particularly since these provisions may provide relief for the smallest of businesses. Companies seeking fi-

[14] Release No. IC 19105 (Nov. 19, 1992).

nancing of under $1 million, so-called "Mom and Pop" companies, may benefit the most from changes such as simplifying the attribution rules under Section 3(c) of the 1940 Act, or raising the limit for closed-end funds to $10 million. Changes such as these may permit local entrepreneurs to create pools of funds and invest them in fledgling businesses. Local investors may seek to hedge their risks or pool their experience as well as their funds to invest in several small businesses, rather than one.

Nonetheless, many of the other changes, while well-intended, are immensely complicated. I find it difficult to imagine that many investors are going to work through the requirements of a BDC. While the requirements for a BDC would be much improved under this legislation, it is still going to require the professional assistance of bankers and attorneys to make these structures workable. Well-to-do local investors seeking to place their funds in-small businesses will simply look for other avenues. Accordingly, my view is that the Small Business Incentive Act is a good start, but further steps will be needed to make these investment vehicles useful to very small business. I would recommend broader and simpler exemptions from the 1940 Act to facilitate private pooled investment in small businesses.

2. Small Business Loan Securitization and Secondary Market Enhancement Act of 1993

I also whole-heartedly endorse S. 384, the Small Business Loan Securitization and Secondary Market Enhancement Act of 1993 introduced by Senator D'Amato.[15] This bill is intended to simplify securitization of small business loans by affording them essentially the same treatment currently given to residential mortgages. In general, the bill extends the provisions of the Secondary Mortgage Market Enhancement Act of 1984 ("SMMEA") to small business loans. The bill would modify the following:

(i) *Exchange Act*—The bill would provide certain exemptions from the Exchange Act. The bill would add new Section 3(a)(53) of the Exchange Act, defining "small business related security," ("SBRS"). The bill would define an SBRS, among other things, as a security that is rated in one of the four highest rating categories by at least one nationally recognized statistical rating organization. The legislation would: (a) amend Section 7(g) of the Exchange Act creating an exemption from the margin requirements for broker-dealers to permit delayed delivery of SBRSs; (b) amend Section 8() of the Exchange Act for broker-dealers to state that no person shall be deemed to have borrowed within the ordinary course of business because of a delayed delivery of a SBRS; and (c) amend Section 11(d)(1) of the Exchange Act creating an exemption for delayed delivery of SBRSs from the prohibition against broker-dealers extending credit for a new issue in which the broker-dealer participated in the Selling syndicate. These changes are intended to facilitate the packaging and sales of securities representing the underlying small business loans.

(ii) *SMMEA*—The bill would amend SMMEA to adapt the mechanism that allows packaging of residential mortgage loans to work for SBRSs. Specifically, the bill would amend Section 106(a)(1) of SMMEA to permit entities created under Federal or state law to invest in SBRSs to the same extent as the entities are allowed to invest in U.S. or agency securities. It also would amend Section 106(a)(2) of SMMEA by specifying that where state law limits entities to investing in securities issued by the U.S., SBRSs would be considered obligations of the U.S. Further the bill would amend Section 106(c) of SMMEA to eliminate the registration of SBRSs with state Blue Sky authorities. As with mortgage-related securities, the bill would give states seven years after the date of enactment to enact laws requiring state regulation of SBRSs.

(iii) *OCC Regulations Regarding Capital Requirements for Depository Institutions*—Section 8 of the bill would provide incentives for depository institutions to securitize loans, without jeopardizing their capital or adversely affecting their financial statements. It also facilitates investment by depository institutions in SBRSs. Section 8(a) of the bill provides that the accounting principles applicable

[15] Senator Alfonse M. D'Amato (R-NY), the Ranking Republican Member of the Senate Committee on Banking, Housing, and Urban Affairs, introduced S. 384 on February 17, 1993. Original co-sponsors include Senators Christopher Dodd, (D-CT), Chairman of the Securities Subcommittee; Richard H. Bryan, (D-NV); Christopher S. Bond, (R-MO); Phil Gramm, (R-TX), Ranking Republican Member of the Securities Subcommittee; Connie Mack, (R-FL); Lauch Faircloth, (R-NC); Robert Bennett, (R-UT); Pete V. Domenici, (R-NM); Richard C. Shelby, (D-AL); John H. Chafee, (R-RI); Don Nickles, (R-OK); Kent Conrad, (D-ND); Frank H. Murkowski, (R-AK); Ted Stevens, (R-AK); Joseph I. Lieberman, (D-CT); William S. Cohen, (R-ME); Larry Pressler, (R-SD); Slade Gorton, (R-WA); Nancy Kassebaum, (R-KS); John C. Danforth, (R-MO); Jim M. Jeffords, (R-VT). *See* 139 Cong. Rec. S1742 (daily ed. Feb. 17, 1993) (statement of Senator D'Amato) ("Statement of Senator D'Amato").

to the transfer of a small business loan with recourse for reports filed with Federal banking agencies shall be uniform and consistent with generally accepted accounting principles. Section 8(b) provides that the amount of capital required to be maintained by an insured institution will not exceed an amount sufficient to meet the institution's reasonable estimated—liability under recourse arrangements. Section 8(c) provides that under the risk-based capital requirements applicable to insured depository institutions, a SBRS (as distinguished from any securitized small business loan) shall be treated as a similarly rated mortgage-backed security.

(iv) *ERISA*—Section 9 of the bill directs the Secretary of Labor, in consultation with the Secretary of the Treasury, to exempt transactions involving SBRSs from certain restrictions under the Employee Retirement Income Security Act of 1974 ("ERISA"). The provision would permit financial institutions that manage pension funds to participate in the pooling and packaging of small business loans for sale as securities.[16]

(v) *Tax Code*—Section 10 of the bill would direct the Secretary of the Treasury to promulgate regulations providing for the taxation of a small business loan investment conduit and the holder of an investment in such a conduit, similar to the taxation of real estate mortgage investment conduits ("REMICs"). This is the same approach that Congress took in 1986 when it adopted REMIC rules that cover the sale of mortgage backed securities.[17]

Comments

I believe these modifications would, as a package, make a meaningful difference in the ability of small businesses to obtain new capital.

Congress has the chance to facilitate the development of small business securitization in much the same fashion as it facilitated the development of mortgage loan securitization. S. 384 is an excellent start in that effort. Securitization is a "chicken and egg" problem, in that the private sector might be willing to securitize small business loans, but finds many regulatory impediments. Legislators and regulators might want to modify the legal framework to permit such securitization, but are not certain how to fashion relief since no market has emerged. Although this situation is a recipe for stalemate, this Subcommittee wisely has made the first move.

Small businesses will have an easier time obtaining loans if they have access to the funds of pension plans and other institutions. Packaging loans presents opportunities to hedge risk and make small business loans more attractive to other institutional investors. Altering capital requirements for depository institutions encourages banks to make small business loans and then in turn reduce their capital charges once those loans are securitized. All of these steps make sense and should help the process of small businesses loan securitization.

There are some important differences between mortgage loans and small business loans. These inherent limitations will alter the structured and operation of the small business loan-backed securities market. When mortgage loans are pooled, individual mortgage loans are typically small, perhaps $75,000 or $100,000 each. Packaging of such small loans permits substantial diversity in geography and other factors in the mortgages comprising a pool. For example, a $20 million mortgage pool would have 200 mortgages of $100,000. Accordingly, the failure of a few mortgages will not greatly harm the pool as a whole. By comparison, small business loans typically might be in the range of $1 to $5 million for companies falling under the definition of a small business. As a consequence, a $4 million loan would represent 20 percent of a $20 million pool. While these numbers may be somewhat exaggerated, they serve to illustrate this point of statistical significance.

The effect of this difference is that, unfortunately, securitized small business loans may be more likely to be priced and traded like corporate debt than mortgage-backed securities. Since mortgage-backed securities are not dependent on one or two individual mortgage loans, and since each portfolio meets high underwriting standards, pricing depends much more on general economic trends, such as rates on long term Treasury securities, inflationary expectations, and consumer confidence. By comparison, small business loan-backed securities will be linked much more closely to the fortunes of specific companies. As a consequence, analysts and trading desks will attempt to evaluate the individual companies underlying the loans when pricing and trading the securities.

Of course, if the size of an offering becomes very large, then, as with mortgages-backed securities, the fortunes of individual companies become less significant in

[16] Statement of Senator D'Amato, at S1742–3.
[17] *Id.* at S1743.

pricing decisions. But because the average loan size for small business loans would be much higher than for mortgages, the size of a "generic" pool would need to be much larger. It is difficult to imagine that these pools will be large, at least during the formative stages of the market.

Requiring an "investment grade" rating from a nationally recognized statistical security rating agency is certainly a good step toward safeguarding investors in this new market, but raises other issues as well. To protect their reputations and the capital of potential investors, these agencies' initial responses to structuring proposals are likely to be very conservative. Not unlike the mortgage market several years ago, before the emergence of Fannie and Freddie as the key players, the levels of subordination required on pools of small business loans to obtain these investment grade ratings may be onerous. While this problem should abate over time as historical performance data is compiled and analyzed, early attempts by the private sector to significantly lower all-in borrowing costs for small issuers will undoubtedly encounter difficult obstacles.

The question then becomes whether Congress should take a more interventionist approach and create another Government Sponsored Entity ("GSE") to facilitate securitizing small business loans. I understand that the House is considering just such legislation, H.R. 660, the Small Business Credit Availability Act of 1993, which would create the Venture Enhancement and Loan Development Administration for Small Undercapitalize Enterprises, or "Velda Sue." Congress has the fundamental policy decision of whether to create a GSE or to allow the private sector to fill this gap.

There is no escaping that a GSE, with its implicit Federal guarantee would eventually facilitate larger primary and secondary markets. Inevitably, the marketplace would accept Velda Sue bonds because of the assumption that in the event of a default, the Federal Government would indemnify Velda Sue. Even if its securities were to state in neon letters that the paper is not guaranteed by the U.S. Government, the market has always believed that the Government would not let Fannie, Freddie, or Ginnie fail, and presumably would not let Velda fail either. Accordingly, current GSE securities trade on average within 100 basis points of equivalent Treasuries.

Velda Sue-backed paper would act as a subsidy for small business. It is seductive for the Federal Government to provide this subsidy, because the Congress needs only to create the GSE to convey these benefits. Without spending a dollar, borrowing costs fall for small businesses and investor demand for the paper rises. In addition, the sheer size and competitive position of Velda Sue would permit it to set minimum underwriting standards for loans, thereby encouraging standardization for loan agreements and other necessary documents, and providing some protection to the agency and, ultimately, the taxpayer.

But Congress must balance against these benefits the very substantial detriments to creating a new GSE. The taxpayer would indeed be on the hook for all failures exceeding Velda Sue's means. One of the reasons that capital costs for small businesses are high is because the failure rate of small business is high. A Federal guarantee will not alter the fundamental fact that one reason why small businesses have trouble raising capital is because of that high failure rate. By creating Velda Sue, Congress is making the taxpayer the guarantor of that "spread" between the market rate and the subsidized rate for small business loans, bearing in mind that some of this "spread" can be monetized and reserved against possible future losses. As with any new venture, there inevitably are missteps that could cause substantial losses to the taxpayer. In the aftermath of the savings & loan debacle, Congress must weigh carefully the risks of undertaking additional contingent liabilities.

In addition to these drawbacks, Velda Sue will itself crowd out other new enterprise. Private poolers would have an enormously difficult time competing product-for-product with Velda Sue. Regardless of how competitive and well-managed private poolers are, private entities cannot offer protections and lowered borrowing costs that only a GSE can provide. Velda Sue may crowd out private businesses, including the possibility that small businesses themselves will become involved in pooling and marketing small business loans. In addition, private poolers are more likely to be innovative in creating different kinds of pools or creating new types of securities. Although the existing GSEs deserve high points for responsiveness, the private sector usually provides the most creativity with the greatest dispatch. By creating a GSE, Congress runs the risk of hampering this creativity.

But while acknowledging the pluses and minuses of a new GSE, I am convinced that Congress should take the steps contemplated by S. 384. Whether or not Congress creates a new GSE, it should facilitate the development of a purely private market in securitized small business loans. Indeed, one could argue that the private

pooling approach should be given a "head start" to become established before considering the creation of a GSE, which would have significant competitive advantages.

Perhaps a much smaller guarantee program, designed only to insure against catastrophic loss in any pool, could be implemented more quickly. A prudent, statistically derived combination of a hold-back out of loan proceeds to each borrower, a reserve fund funded out of "excess spread" on each loan, and an incremental government guarantee might serve to bring total borrowing costs to acceptable levels. At a minimum, such a program would, I believe, generate serious investment consideration of subordinated securities in such pools from the broader investment community. Such a structure could be developed by borrowers, investors, Wall Street, the rating agencies and, perhaps, currently existing bond insurance companies.

Securitizing small business loans will help small businesses raise money. S. 384 is an important catalyst for that effort. I am optimistic that by removing unnecessary regulatory impediments, this market can flourish. But if the private market does not develop, Congress may revisit the issue at a later point and consider whether to establish a GSE at that time.

Conclusion

I commend this Subcommittee for addressing these issues at a time when so much attention is being focussed on the economy. The steps you are contemplating could allow small business to grow and create new jobs. Small business is a major, and often unnoticed, engine of our Nation's economy. The actions you are contemplating would remove substantial obstacles to capital raising. At the same time, I am convinced that the bills retain substantial investor protection and would not cause public harm. Finally, these important efforts will not cost the taxpayer one dime, now, or in the future.

I appreciate the opportunity to testify and would be glad to answer any questions.

* * * * * *

Attachment I

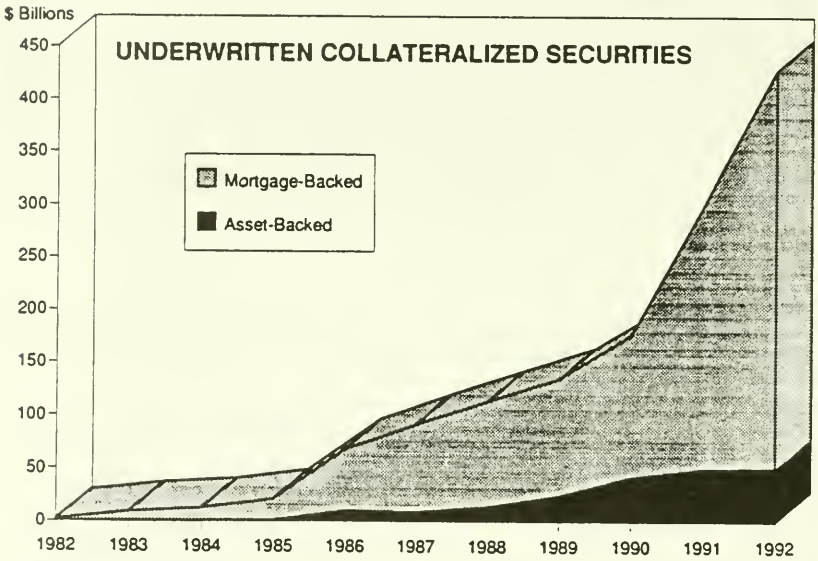
Underwritten Collateralized Securities; Asset Backed Securities; Recent Initial Public Offerings and Secondary Offerings—Ranked by State. Prepared by the Securities Industry Association.

Attachment II

Discussion of Amendments to the Investment Company Act of 1940 ("1940 Act").

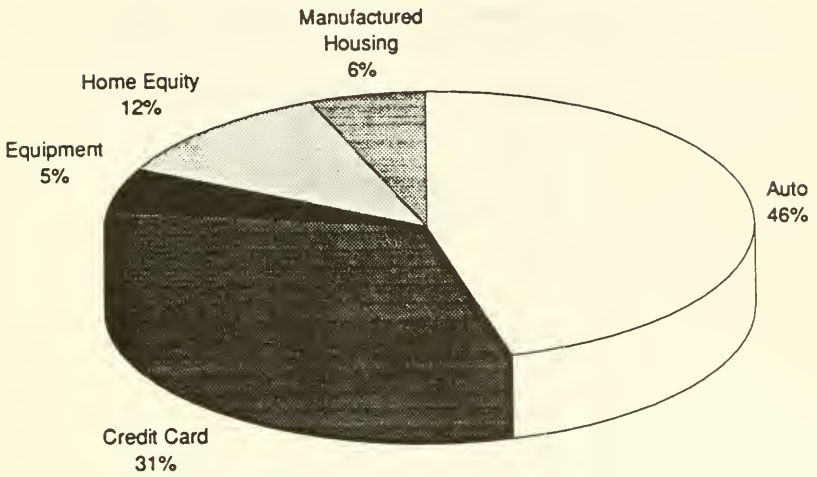
Attachment I

Underwritten Collateralized Securities; Asset Backed Securities; Recent Initial Public Offerings and Secondary Offerings - Ranked by State. Prepared by the Securities Industry Association.



Source: Securities Data Company

1992 Asset-Backed Securities Offerings



Auto = Auto, Truck, RV and Boat Loans
Creidt Card = Credit Card, Charge Card, and Consumer Loans
Equipment = Equipment Purchase, Leasing and Promissary Notes
Home Equity = Revolving Credit and Home Equity Loans

1992 INITIAL PUBLIC OFFERINGS

Deal Size	# Deals	Total $ mils
up to $5 mil	67	280
5+ to 10	76	531
10+ to 20	90	1,396
20+ to 50	163	5,312
50+ to 100	61	4,327
100+ to 200	36	5,124
over 200	18	7,024
Total	**511**	**23,995**

1992 COMMON STOCK SECONDARIES

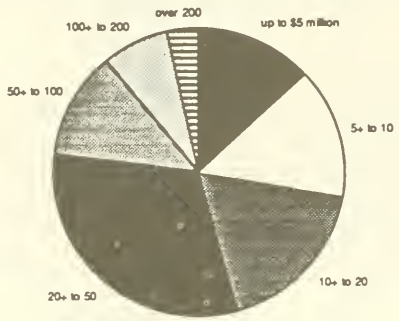
Deal Size	# Deals	Total $ mils
up to $5 mil	43	143
5+ to 10	41	295
10+ to 20	68	973
20+ to 50	165	5,519
50+ to 100	96	6,630
100+ to 200	52	7,107
over 200	30	12,905
Total	**495**	**33,572**

Note: Excludes mutual funds and best-efforts underwritings

The foregoing data on firm commitment underwritings of initial public offerings (IPOs) and seasoned company common stock secondary underwritings constitute only one portion of the capital raised by large and small companies. Underwritings of closed-end mutual funds, where the proceeds accrue to the fund (which invests in companies' stock) but not directly to a company, are excluded. Also excluded are best-efforts underwritings because data are not currently available on these type of offerings. Best-effort underwritings, where the underwriter agrees to use his best-efforts to place the deal but does not guarantee a successful placement by "firmly committing" its own capital up front, are almost exclusively used for small company underwritings, particularly IPOs, including almost every "Regulation A and D" offering. The data also do not include equity raised through preferred stock sales; equity raised directly without an underwriting; venture capital; private placements, warrant issues, etc.

Issues of $5 million and under accounted for 13% of the number of new companies brought to market for the first time (IPOs) in 1992.

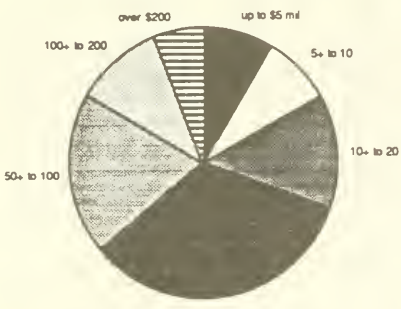
1992 IPO Distribution by Number of Deals



Distribution by number of deals in each size category, i.e.
67 deals, or 13% were for $5 million or less each.

In addition, 9% of the number of seasoned companies (those with stock already publicly traded) which underwrote stock in 1992 did so with deals of $5 million or less.

1992 Seasoned Stock Underwriting
Distribution by Number of Deals



Distribution by number of deals in each size category, i.e.
43 deals, or 9%, were for $5 million or less each.

1992 U.S. INITIAL PUBLIC OFFERINGS (IPOs)

Deals	$ Millions	Home of Issuer
1	29.6	Alabama
6	90.2	Arizona
2	188.9	Arkansas
92	2,618.2	California
10	149.1	Colorado
13	503.9	Connecticut
2	169.6	D. of Columbia
2	98.0	Delaware
21	451.2	Florida
12	417.3	Georgia
1	69.8	Hawaii
17	747.1	Illinois
5	199.7	Indiana
2	160.4	Iowa
4	106.8	Kansas
1	15.0	Kentucky
3	201.0	Louisiana
1	2.8	Maine
3	96.0	Maryland
38	1,406.5	Massachusetts
10	1,095.9	Michigan
18	474.9	Minnesota
2	32.7	Mississippi
11	152.3	Missouri
1	63.0	Montana
3	70.8	Nebraska
2	37.8	Nevada
2	43.8	New Hampshire
22	995.6	New Jersey
2	12.3	New Mexico
48	3,671.0	New York
10	846.4	North Carolina
12	743.9	Ohio
1	120.0	Oklahoma
2	37.5	Oregon
16	727.8	Pennsylvania
4	371.2	Rhode Island
4	219.0	South Carolina
12	1,247.8	Tennessee
39	1,197.2	Texas
4	116.4	Utah
8	452.4	Virginia
4	151.0	Washington
4	356.6	Wisconsin
34	3,036.9	Foreign
477	23,995.3	Total

Note: Firm committment underwritings of companies' common stock for which, prior to this offering, there was n public market; excludes mutual funds.

1992 U.S. INITIAL PUBLIC OFFERINGS (IPOs)

(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
1	29 6	Books-A-Million	Alabama	Own and operate book stores	Robinson-Humphrey
1	14 0	Megafoods Stores	Arizona	Own and operate supermarkets	Piper, Jaffray & Hopwood
2	16 0	American Insurance Group	Arizona	Surety insurance co,hldg co	Ladenburg, Thalmann
3	19 3	First Western	Arizona	Provide mortgage banking svcs	Prudential Securities Inc
4	2 5	Reconditioned Systems	Arizona	Own,op drapery stores	Norcross Securities, Inc
5	33 4	Microtest	Arizona	Mnfr LAN monitoring devices	Hambrecht & Quist
6	5 0	Simula	Arizona	Mnfr aircraft safety equipment	W B McKee Securities
	90 2				
1	13 1	USA Truck	Arkansas	Trucking company	Stephens
2	175 8	Arkansas Best	Arkansas	Trucking company	First Boston
	188.9				
1	10 0	Biocircuits	California	Manufacture diagnostic tests	Hambrecht & Quist
2	10 0	Cholestech	California	Mnfr diagnostic test kits	Kemper Securities
3	10 5	Cardiovascular Imaging Systems	California	Mnfr medical imaging systems	Montgomery Securities
4	11 9	On Assignment	California	Pvd temp scientific personnel	Advest
5	115 0	Dames & Moore	California	Provide engineering services	Kidder, Peabody
6	12 0	Physicians Clinical Laboratory	California	Pvd medical lab services	Smith Barney, Harris Upham
7	14 0	Access Health Marketing	California	Pvd information retrieval svcs	Alex. Brown & Sons
8	14 3	ICU Medical	California	Manufacture medical equipment	Sutro
9	14 8	Sport Chalet	California	Own,op sporting goods stores	Wedbush Morgan Securities
10	16 0	Imperial Credit Industries	California	Mortgage banking services	PaineWebber
11	16 0	Telios Pharmaceuticals	California	Mnfr pharmaceutical products	Morgan Stanley
12	16 3	Regency Health Services	California	Own,op hospitals,whl drugs	County NatWest Securities Ltd
13	16 3	Satellite Technology Mgmt	California	Mnfr satellite commun equip	H J Meyers
14	17 5	StrataCom	California	Manufacture telecommun equip	Montgomery Securities
15	18 0	Supermac Technology	California	Provide software services	Montgomery Securities
16	18 8	Natural Wonders	California	Own and operate novelty shops	Morgan Stanley
17	180 0	Foodmaker	California	Operate,franchise restaurants	Morgan Stanley
18	19 2	Enhanced Imaging Technologies	California	Manufacture HDTVs	Prudential Securities Inc
19	19 5	Fresh Choice	California	Own and operate restaurants	Alex Brown & Sons
20	20 2	Meadowbrook Rehabilitation Grp	California	Operate rehabilitation hosp	J C Bradford

1992 U.S. INITIAL PUBLIC OFFERINGS (IPOs)
(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
21	21 8	Sciclone Pharmaceuticals	California	Mnfr,whl pharmaceuticals	Josephthal Lyon & Ross, Inc.
22	22 0	Glacier Water Services	California	Mnfr water vending machines	Sutro
23	22 0	Learning	California	Develop educational software	Morgan Stanley
24	22.1	Summit Care	California	Own and operate nursing homes	Dillon, Read
25	22 3	Exstar Financial Corporation	California	Pvd fire,marine insurance svcs	Chicago Corporation
26	23 6	Day Runner	California	Manufacture daily planners	Montgomery Securities
27	23 9	Abaxis	California	Mnfr blood testing equipment	Furman Selz Inc
28	24 0	Network Computing Devices	California	Manufacture computer terminals	Morgan Stanley
29	25 0	Dura Pharmaceuticals	California	Mnfr,whl pharmaceuticals	Oppenheimer
30	26 0	Chemtrak	California	Mnfr,whl diagnostic tests	Dean Witter Reynolds
31	26 0	Triconex	California	Mnfr process control equipment	Smith Barney, Harris Upham
32	26 3	Kennedy-Wilson	California	Real estate auction services	Oppenheimer
33	27 0	Nettrame Systems	California	Manufacture electn computers	Lehman Brothers
34	28 0	Frame Technology	California	Computer programming services	Hambrecht & Quist
35	28 8	Synopsys	California	Manufacture computers	Morgan Stanley
36	28 8	Valence Technology	California	Mnfr rechargeable batteries	Montgomery Securities
37	3 8	Intelligent Surgical Laser	California	Manufacture surgical lasers	PaineWebber
38	30 0	Corvas International	California	Manufacture pharmaceuticals	PaineWebber
39	31 2	Biosys	California	Mnfr pharmaceutical products	Kemper Securities
40	31 5	Walker Interactive Systems	California	Dvlp accounting software	Morgan Stanley
41	32 5	Plaza Home Mortgage	California	Mortgage bankers	Kidder, Peabody
42	33 6	Authentic Fitness Corp	California	Own and operate gymnasiums	Morgan Stanley
43	35 0	Platinum Software	California	Develop modular software	Hambrecht & Quist
44	36 0	Catalina Marketing	California	Marketing consulting services	PaineWebber
45	36 0	First Pacific Networks	California	Dvlp utility control sys	Nomura Securities New York Inc
46	36 0	Stac Electronics	California	Manufacture modems	Alex. Brown & Sons
47	38 3	Electronics for Imaging, Inc	California	Manufacture imaging equipment	Robertson Stephens
48	38 3	Fritz Companies	California	Freight forwarding services	Morgan Stanley
49	39 0	American Residential Holding	California	Provide mtg banking services	Morgan Stanley
50	39 0	Curallex Health Services	California	Operate dialysis centers	Morgan Stanley
51	39 9	HS Resources	California	Oil and gas exploration,prodn	Lehman Brothers
52	4 2	Ophthalmic Imaging Systems	California	Mnfr,design,market imaging sys	Kashner Davidson Securities
53	4 3	Alamar Biosciences	California	Mnfr pharma preparations	Commonwealth Associates
54	4 5	Document Technologies Inc	California	Develop software,mnfr hardware	Paulson Investment
55	4 7	Universal Self Care	California	Own,op self care stores	Westfield Financial Corp

1992 U.S. INITIAL PUBLIC OFFERINGS (IPOs)

(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
56	40 5	Target Therapeutics	California	Mnfr,whl mini-surgical devices	Alex. Brown & Sons
57	40 6	Xircom	California	Pvd computer systems analysis	Morgan Stanley
58	41 2	ChipSoft	California	Develop software	Robertson Stephens
59	41 3	Abbey Healthcare Group	California	Provide home infusion services	Dillon, Read
60	41 3	Endosonics	California	Mnfr image processing equip	Piper, Jaffray & Hopwood
61	41 3	Ligand Pharmaceutical	California	Manufacture diagnostic tests	Lehman Brothers
62	41 6	McAlee Associates	California	Develop software	Robertson Stephens
63	44 8	Amylin Pharmaceuticals	California	Pharmaceutical research firm	Morgan Stanley
64	45 0	Media Vision, Inc.	California	Develop software products	Montgomery Securities
65	46.7	Cheesecake Factory	California	Own and operate restaurants	Montgomery Securities
66	5 0	3Net Systems	California	Develop software	Werbel-Roth Securities
67	5 0	Biotime	California	Manufacture blood substitutes	Emanuel
68	5 0	Las Vegas Entertainment	California	Provide pay television svcs	D. H. Blair
69	5 0	Natural Earth Technologies	California	Mnfr, Whl lawn and garden prod	Paragon Capital
70	5 0	Sellectek	California	Manufacture electric equipment	Dakin Securities Corp.
71	5 1	MRV Communications	California	Manufacture semiconductors	Thomas James Associates
72	5 3	Integrated Process Equipment	California	Manufacture computer disks	D. H. Blair Investment Banking
73	5 4	First Mortgage	California	Provide mortgage banking svcs	Crowell, Weedon
74	5 5	Voice Powered Technology Intl	California	Develop software	Drake Capital Securities
75	51 0	PeopleSoft	California	Develop software	Goldman, Sachs
76	51 0	Trident Microsystems	California	Mnfr chips,circuit boards	Alex. Brown & Sons
77	52 0	Callaway Golf	California	Manufacture golf clubs	Merrill Lynch & Co.
78	52 5	Matrix Pharmaceutical	California	Mnfr pharmaceutical products	First Boston
79	52 5	Protein Design Labs	California	Mnfr therapeutic products	Merrill Lynch & Co.
80	56 0	Pyxis Corporation	California	Provide med equip leasing svcs	Merrill Lynch & Co.
81	6 0	Consumer Portfolio Services	California	Provide loan brokerage svcs	Whale Securities
82	6 0	Premiere Radio Networks	California	Cellular telephone commun svcs	Fahnestock
83	6 0	XXsys Technologies	California	Mnfr measuring devices	Thomas James Associates
84	6 3	Cypros Pharmaceutical	California	Mnfr biological products	A.R. Baron & Co., Inc.
85	6 6	Intramed Laboratories	California	Mnfr surgical equipment	H. J. Meyers
86	63 3	North American Mortgage	California	Provide mortgage banking svcs	Merrill Lynch & Co.
87	67 2	Providential	California	Provide mortgage banking svcs	Prudential Securities Inc.
88	7 5	Wilshire Technologies	California	Whl medical,dental,hosp equip	Cruttenden & Co. Inc.
89	75 0	Gilead Sciences	California	Provide research, dvlp svcs	Robertson Stephens
90	84 6	Ventritex	California	Mnfr,whl defibrillators	Robertson Stephens

1992 U.S. INITIAL PUBLIC OFFERINGS (IPOs)

(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
91	9 0	Metricom	California	Mnfr local commun systems	Cowen
92	9 4	Protein Polymer Technologies	California	Mnfr protein polymers	Reich
	2618.2				
1	23 1	St Mary Land & Exploration	Colorado	Oil,gas exploration,prodn	Hanifen, Imhoff
2	26 6	Basin Exploration	Colorado	Oil and gas exploration, prodn	Donaldson, Lufkin & Jenrette
3	3 9	Marcum Natural Gas Services	Colorado	Gas utility	Cohig & Associates
4	32 0	Cortech	Colorado	Pharmmaceutical research firm	Montgomery Securities
5	33 8	Spectranetics	Colorado	Manufacture medical lasers	Kiddor, Peabody
6	4 0	On-Gard Systems	Colorado	Whl medical,dental equipment	Royce Investments
7	4 0	Soricon	Colorado	Mnfr optical scanning equip	Cohig & Associates
8	6 5	CliniCom	Colorado	Provide computer related svcs	Vantage Securities
9	6 9	IntoNow	Colorado	Manufacture vending machines	D H Blair
10	8 3	Bestop	Colorado	Manufacture automobile parts	Dain Bosworth
	149.1				
1	14 0	NPM Healthcare Products, Inc	Connecticut	Whl pharmaceutical products	Advest
2	14 3	Farrel	Connecticut	Manufacture industrial equip	PaineWebber
3	165 6	National Re Holdings	Connecticut	Ppty,casualty reinsurance co	Merrill Lynch & Co
4	186 7	Life Re	Connecticut	Life reinsurance company	Salomon Brothers
5	28 8	United Waste Systems	Connecticut	Provide waste management svcs	PaineWebber
6	4 2	New World Power	Connecticut	Elec utility,mnfr generators	Dickinson & Co
7	5 0	Northern Springs	Connecticut	Produce bottled water	Network 1 Financial Securities
8	5 4	IVF America	Connecticut	Miscellaneous health care svcs	Robert Todd Financial Corp
9	51 3	Micro Warehouse	Connecticut	Pvd computer mail-order svcs	Montgomery Securities
10	6 2	Managed Health Benefits	Connecticut	Health insurance company	A S. Goldmen & Company
11	6 6	Health Image Media	Connecticut	Publish magazines	D H Blair
12	7 2	Energy Research	Connecticut	Provide research services	Reich
13	8 6	Electronic Information Sys	Connecticut	Mnfr telemarketing equipment	Unterberg Harris De Santis
	503.9				
1	165 0	Allied Capital Commercial	D. of Columbia	Real estate investment trusts	Lehman Brothers
2	4 6	Capitol Multimedia	D of Columbia	Motion pictures prodn services	Noble Investment Co
	169 6				

1992 U.S. INITIAL PUBLIC OFFERINGS (IPOs)

(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
1	28 8	PCI Services	Delaware	Pvd product packaging services	Smith Barney, Harris Upham
2	69 2	American Income Holdings	Delaware	Insurance holding company	Morgan Stanley
	98 0				
1	1 2	Firstat of America	Florida	Provide home health care svcs	Peterson Brothers Securities
2	16 5	Equitrac	Florida	Design computer integrated sys	Dean Witter Reynolds
3	18 4	Intermedia Commun of Florida	Florida	Telecommunications services	Bear, Stearns
4	26 5	Engle Homes	Florida	Construct single-family homes	PaineWebber
5	3 6	RT Industries	Florida	Manufacture automotive parts	Stuart, Coleman
6	3 9	Clucker's Wood Roasted Chicken	Florida	Own,op fast food restaurants	Noble Investment Co
7	4 0	Golden Eagle Group	Florida	Provide insurance facilities	Vantage Securities
8	4 2	Princeton Dental Management	Florida	Provide dental management svcs	A S. Goldmen & Company
9	4 3	Universal Heights	Florida	Nondurable goods	Noble Investment Co
10	4 6	ECO2	Florida	Mnfr special industry mach	Elliot Allen & Co., Inc.
11	4 9	Austin's International	Florida	Own and operate restaurants	Noble Investment Co
12	42 3	Stein Mart	Florida	Operate department stores	First Boston
13	46 9	Lincare Holdings	Florida	Provide oxygen treatment svcs	Dean Witter Reynolds
14	5 0	TelMed	Florida	Provide home health care svcs	South Richmond Securities
15	5 1	Heart Labs of America	Florida	Operate medical laboratories	Noble Investment Co
16	6 5	CliniCorp	Florida	Chiropractic clinic	RAS Securities Corporation
17	6 5	International Fast Food	Florida	Operate Burger King franchises	Whale Securities
18	62 1	Discount Auto Parts	Florida	Own and op auto parts stores	Smith Barney, Harris Upham
19	87 5	Sports & Recreation	Florida	Operate sporting goods stores	First Boston
20	88 2	John Alden Financial	Florida	Life,health insurance hldg co	First Boston
21	9 0	Todhunter International	Florida	Produce whiskey	Dain Bosworth
	451.2				
1	120 0	Caraustar Industries	Georgia	Mnfr boxes;whl waste paper	Goldman, Sachs
2	13 5	IQ Software	Georgia	Develop data access software	William Blair
3	19 8	Forstmann	Georgia	Manufacture wool fabrics	Prudential Securities Inc.
4	22 8	Sportstown	Georgia	Operate sporting goods stores	Prudential Securities Inc.
5	27 5	Premier Anesthesia	Georgia	Provide health and allied svcs	Hambrecht & Quist
6	28 8	Longhorn Steaks	Georgia	Own and operate steakhouses	J C. Bradford
7	3 4	Peachtree Fiberoptics	Georgia	Mnfr fiber optic cables	J W Charles Securities
8	32 5	National Vision Associates	Georgia	Operate optical goods stores	Robinson-Humphrey

1992 U S. INITIAL PUBLIC OFFERINGS (IPOs)
(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
9	37 5	Roper Industries	Georgia	Mnfr indl pumps, machinery	Smith Barney, Harris Upham
10	40 5	Mohawk Industries	Georgia	Manufacture carpets and rugs	First Boston
11	63 0	AGCO	Georgia	Mnfr farm, garden machinery	First Boston
12	8 0	Parma Fix Environmental	Georgia	Pvd waste treatment svcs	A S Goldmen & Company
	417.3				
1	69 8	Schuler Homes	Hawaii	Construct single-family homes	Montgomery Securities
1	10 4	Ha-Lo Industries	Illinois	Direct selling establishments	Hamilton Investments
2	14 6	Value Added Communications	Illinois	Pvd communications services	Ladenburg, Thalmann
3	144 0	John Nuveen	Illinois	Investment bank	Goldman, Sachs
4	16 0	Option Care	Illinois	Home infusion therapy services	Alex Brown & Sons
5	19 0	International Jensen	Illinois	Mnfr radios and televisions	William Blair
6	195 0	TNT Freightways	Illinois	Provide trucking services	Goldman, Sachs
7	20 0	TRO Learning	Illinois	Develop educational software	Volpe, Welty & Company
8	22 5	Alden Press	Illinois	Provide web printing services	William Blair
9	35 0	Health o meter Products	Illinois	Manufacture medical equipment	First Boston
10	4 8	R2 Medical Systems	Illinois	Manufacture medical equipment	Vantage Securities
11	45 0	Bell Sports	Illinois	Manufacture bicycle parts	William Blair
12	45 0	Sportmart	Illinois	Sporting goods,bicycle shops	Bear, Stearns
13	48 0	SPS Transaction Services	Illinois	Provide data processing svcs	Dean Witter Reynolds
14	54 0	Duff & Phelps	Illinois	Investment advisory services	Merrill Lynch & Co
15	57 8	ERO Industries	Illinois	Manufacture toys	Donaldson, Lufkin & Jenrette
16	7 0	M Wave	Illinois	Mnfr communication equipment	Kemper Securities
17	9 0	Ben Franklin Retail Stores	Illinois	Operate retail variety stores	Whale Securities
	747.1				
1	23 0	ADESA	Indiana	Wholesale used cars	Robinson-Humphrey
2	27 5	Chromcraft Revington	Indiana	Mnfr metal household furniture	Robinson-Humphrey
3	27 5	Finish Line	Indiana	Athletic footwear ret stores	Oppenheimer
4	37 7	Acordia	Indiana	Insurance brokerage firm	First Boston
5	84 0	CCP Insurance	Indiana	Insurance company	First Boston
	199 7				

1992 U.S. INITIAL PUBLIC OFFERINGS (IPOs)
(Source: Securities Data Company -- excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
1	77 1	Younkers	Iowa	Operate retail dept store	Goldman, Sachs
2	83 3	President Riverboat Casinos	Iowa	Own, operate riverboat casinos	Montgomery Securities
	160.4				
1	16 1	Layne	Kansas	Water well drilling services	Alex Brown & Sons
2	18 9	Lone Star Steakhouse & Saloon	Kansas	Own and operate restaurants	Montgomery Securities
3	5 5	OTR Express	Kansas	Trucking company	Fahnestock
4	66 3	Coleman	Kansas	Mnfr,whl outdoor products	First Boston
	106 8				
1	15.0	Res-Care	Kentucky	Pvd residential,support svcs	J. C. Bradford
1	125 4	Riverwood International	Louisiana	Mnfr paper,paperboard,plywood	J P. Morgan Securities
2	27 0	Seacor Holdings	Louisiana	Water transportation services	Goldman, Sachs
3	48 6	Delta Queen Steamboat	Louisiana	Operate river cruise vessels	Stephens
	201.0				
1	2.8	Nyer Medical Group	Maine	Wholesale medial equipment	Shamrock Partners, Ltd
1	40 8	Vitalink Pharmacy Services	Maryland	Wholesale pharmaceuticals	Kidder, Peabody
2	48 0	Univax Biologics	Maryland	Mnfr immunotherapeutic agents	Montgomery Securities
3	7 2	Microcarb	Maryland	Mnfr biological products	D H Blair
	96.0				
1	11 5	Medical Diagnostics, Inc	Massachusetts	Provide diagnostic services	First Albany
2	143 2	Bradlees	Massachusetts	Own,op department stores	Merrill Lynch & Co.
3	15 0	Kopin	Massachusetts	Mnfr electron and x-ray tubes	Tucker Anthony
4	16 0	Alpha Beta Technology	Massachusetts	Mnfr biological products	Alex Brown & Sons
5	16 0	Brooktrout Technology	Massachusetts	Dvlp integrated voice,fax sys	Tucker Anthony
6	16 2	Vmark Software	Massachusetts	Develop software	Hambrecht & Quist
7	17 5	PerSeptive Biosystems	Massachusetts	Mnfr chromatography equipment	Alex. Brown & Sons
8	18 0	All For A Dollar	Massachusetts	Own and operate variety stores	Ladenburg, Thalmann

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(Source: Securities Data Company -- excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
9	18 0	Kronos	Massachusetts	Manufacture computers	Hambrecht & Quist
10	18 2	MicroTouch Systems	Massachusetts	Mnfr computer peripheral equip	Montgomery Securities
11	2 5	Mr Bulb	Massachusetts	Wholesale lighting products	Texas Capital Securities
12	20 4	Opta Food Ingredients	Massachusetts	Mnfr food additive chemicals	Kidder, Peabody
13	21 0	Creative BioMolecules	Massachusetts	Biological research svcs	Montgomery Securities
14	21 0	Zoll Medical	Massachusetts	Manufacture medical equipment	First Boston
15	22 0	Cellcor	Massachusetts	Mnfr phramaceutical products	Furman Selz Inc
16	23 0	Vision Sciences	Massachusetts	Mnfr electromedical equip	Kidder, Peabody
17	24 8	Arch Communications Group	Massachusetts	Paging communications services	Cowen
18	240 0	Computervision	Massachusetts	Mnfr, design and svc computers	Lehman Brothers
19	25 5	American Medical Response	Massachusetts	Provide ambulance services	Ladenburg, Thalmann
20	28 0	Banyan Systems	Massachusetts	Devlp network system software	Robertson Stephens
21	28 6	EcoScience	Massachusetts	Manufacture biopesticides	Oppenheimer
22	28 8	Seragen	Massachusetts	Manufacture diagnostic agents	Goldman, Sachs
23	28 9	Back Bay Restaurants Group	Massachusetts	Operate Italian, Amer rest	Tucker Anthony
24	29 3	CrossComm	Massachusetts	Mnfr computer networking equip	Donaldson, Lufkin & Jenrette
25	3 5	BKC Semiconductors	Massachusetts	Mnfr semiconductor devices	Arthur W Wood
26	3 5	Standish Care	Massachusetts	Own and operate nursing homes	J. Edmund & Co.
27	319 6	Boston Scientific	Massachusetts	Manufacture catheters	Goldman, Sachs
28	37 4	Syratech Corp	Massachusetts	Manufacture silver flatware	Allen & Co
29	39 0	PolyMedica Industries	Massachusetts	Mnfr medical products	First Boston
30	41 8	Copley Pharmaceutical	Massachusetts	Mnfr pharmaceutical products	Bear, Stearns
31	44 0	Kendall Square Research	Massachusetts	Computer systems design svcs	Kidder, Peabody
32	45 5	Advantage Health	Massachusetts	Own rehabilitation hospitals	Alex. Brown & Sons
33	5 0	Datawatch	Massachusetts	Manufacture computers	Schneider Securities, Inc
34	5 4	DeWolfe	Massachusetts	Real estate brokerage firm	H C Wainwright & Co
35	5 8	Matritech	Massachusetts	Mnfr diagnostic substances	Hanifen, Imhoff
36	6 6	Palomar Medical Technologies	Massachusetts	Manufacture medical equipment	Thomas James Associates
37	7 5	SatCon Technology	Massachusetts	Mnfr electrical machines	Josephthal Lyon & Ross, Inc
38	8 5	Litchfield Financial	Massachusetts	Provide mortgage banking svcs	J C Bradford
	1406.5				
1	125 4	Hayes Wheels International	Michigan	Mnfr motor vehicle parts	Smith Barney, Harris Upham
2	128 1	Omega Healthcare Investors	Michigan	Real estate investment trust	Bear, Stearns
3	144 3	CompuWare Corp	Michigan	Develop,retail software system	Morgan Stanley

1992 U.S. INITIAL PUBLIC OFFERINGS (IPOs)
(Source: Securities Data Company -- excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
4	20 0	Universal Standard Med Labs	Michigan	Own and operate medical labs	Hambrecht & Quist
5	23 0	Saga Communications	Michigan	Own and operate radio stations	First Boston
6	250 8	Taubman Centers	Michigan	Real estate investment trust	Morgan Stanley
7	26 0	Credit Acceptance	Michigan	Pvd installment loan services	William Blair
8	319 3	Valassis Communications	Michigan	Provide coupon printing svcs	Salomon Brothers
9	52 5	F & M Distributors	Michigan	Op health,beauty aids stores	Merrill Lynch & Co.
10	6 5	Perceptron	Michigan	Mnfr computer vision systems	Nomura Securities Int'l, Inc.
	1095.9				
1	13 1	Braun's Fashions	Minnesota	Women's clothing stores	Piper, Jaffray & Hopwood
2	13 6	Universal Hospital Services	Minnesota	Wholesale medical equipment	Piper, Jaffray & Hopwood
3	14 1	Chronimed	Minnesota	Wholesale pharmaceuticals	Hambrecht & Quist
4	188 9	Musicland Stores	Minnesota	Record stores; holding company	Donaldson, Lufkin & Jenrette
5	22 5	Miles Homes	Minnesota	Own and operate lumber yard	Montgomery Securities
6	25 3	Software Etc Stores	Minnesota	Operate computer stores	Robertson Stephens
7	33 9	Damark International	Minnesota	Provide mail order services	Montgomery Securities
8	4 0	Environmental Technologies	Minnesota	Mnfr measuring devices	Westonka Investments
9	4 1	Eltrax Systems	Minnesota	Pvd health and allied services	R. J. Steichen
10	4 6	Celox	Minnesota	Biological research services	Mathews, Holmquist & Assoc
11	4 6	Serving Software	Minnesota	Develop software	John G. Kinnard
12	4 8	Olympic Financial	Minnesota	Provide loan brokerage svcs	John G. Kinnard
13	48 0	Patterson Dental	Minnesota	Whl dental supplies, equipment	Smith Barney, Harris Upham
14	5 0	Funco	Minnesota	Own and operate toy stores	Miller, Johnson & Kuehn, Inc.
15	5 4	Winthrop Resources	Minnesota	Provide computer leasing svcs	John G. Kinnard
16	6 1	Rottlund	Minnesota	Pvd housing construction svcs	John G. Kinnard
17	6 9	Avecor Cardiovascular	Minnesota	Manufacture medical equipment	John G. Kinnard
18	70 0	Automotive Industries Holding	Minnesota	Mnfr autoparts	Kidder, Peabody
	474.9				
1	14 2	Microtek Medical	Mississippi	Mnfr, whl surgical supplies	A. G. Edwards & Sons
2	18 5	Casino Magic	Mississippi	Own,op casinos	Summit Investment
	32.7				
1	10 0	Central Mortgage Bancshares	Missouri	Mortgage banking firm	Stifel, Nicolaus
2	10 5	Data Research Associates	Missouri	Dvlp integrated computer sys	A. G. Edwards & Sons
3	16 0	Allied Healthcare Products	Missouri	Mnfr hospital, medical equip	Montgomery Securities

1992 U.S. INITIAL PUBLIC OFFERINGS (IPOs)

(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
4	23 1	Rival	Missouri	Mnfr household appliances	Lehman Brothers
5	26 0	Express Scripts	Missouri	Pvd health care mgmt services	Alex. Brown & Sons
6	3 8	Zam's	Missouri	Operate stationery stores	Paragon Capital
7	4 4	Zoltek Companies	Missouri	Mnfr carbon and graphite prods	Pauli & Co Inc
8	4 5	2 Bi 2	Missouri	Whl computers,peripheral equip	RAF Financial
9	4 6	D&K Wholesale Drug	Missouri	Whl drugs,drug proprietaries	Pauli & Co. Inc.
10	43 1	Toastmaster	Missouri	Manufacture toasters	Dean Witter Reynolds
11	6 3	Citation Computer Systems	Missouri	Develop software	William Blair
	152.3				
1	63.0	Buttrey Food and Drug Stores	Montana	Own and operate supermarkets	Morgan Stanley
1	13 3	Gibraltar Packaging Group	Nebraska	Manufacture cardboard	William Blair
2	23 0	Buckle	Nebraska	Women's clothing stores	William Blair
3	34 5	American Business Information	Nebraska	Pvd bus to bus mktg info	Hambrecht & Quist
	70 8				
1	32 5	Boomtown	Nevada	Pvd gambling,betting services	Oppenheimer
2	5 3	Reno Air	Nevada	Passenger airline	Paradise Valley Securities Inc
	37.8				
1	34 4	Salem Sportswear	New Hampshire	Mnfr men's,boys' sportswear	First Boston
2	9 4	Walker Power	New Hampshire	Mnfr electrical equipment	Volpe, Welty & Company
	43 8				
1	105 4	Breed Technologies	New Jersey	Manufacture crash sensors	Goldman, Sachs
2	12 1	GBC Technologies	New Jersey	Whl computers,peripheral equip	Raymond James & Associates
3	15 0	Today's Man	New Jersey	Operate men's clothing stores	Alex. Brown & Sons
4	255 0	Margaretten Financial	New Jersey	Mortgage bank	Salomon Brothers
5	26 3	Tops Appliance City	New Jersey	Own,op electn,appliance stores	Donaldson, Lufkin & Jenrette
6	35 0	CytoRad/Cytogen	New Jersey	Manufacture pharmaceuticals	Merrill Lynch & Co.
7	35 0	Paco Pharmaceutical Services	New Jersey	Pharmaceutical packaging prod	Lehman Brothers
8	35 7	Sybron Chemical Industries	New Jersey	Mnfr industrial chemicals	Morgan Stanley
9	4 8	Environmental Technologies	New Jersey	Wholesale industrial chemicals	Paragon Capital

1992 U.S. INITIAL PUBLIC OFFERINGS (IPOs)

(Source: Securities Data Company -- excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
10	48 4	Bisys Group	New Jersey	Provide data processing svcs	Lehman Brothers
11	55 5	I-Stat	New Jersey	Manufacture medical equipment	Smith Barney, Harris Upham
12	6 0	Defense Software & Systems	New Jersey	Mnfr ground station systems	Laidlaw Equities
13	6 0	Life Medical Sciences	New Jersey	Pvd medical research services	D. H. Blair
14	6 0	Medical Resources	New Jersey	Pvd diagnostic imaging svcs	Raymond James & Associates
15	6 0	United States Paging	New Jersey	Provide paging services	Gruntal
16	66 0	United Retail Group	New Jersey	Own and operate dept stores	Goldman, Sachs
17	76 8	Hospitality Franchise Systems	New Jersey	Own,op hotel franchises	Merrill Lynch & Co
18	8 0	Inlu-Tech	New Jersey	Pvd infusion therapy services	Emanuel
19	8 6	Envirogen	New Jersey	Biologically engineered prods	Allen & Co
20	85 0	Bed Bath & Beyond	New Jersey	Operate homefurnishing stores	Goldman, Sachs
21	9 0	MedQuist	New Jersey	Home health care services	Wheat First Butcher & Singer
22	90 0	Fleet Call	New Jersey	Cellular telephone services	Merrill Lynch & Co.
	995.8				
1	4 0	SBS Engineering	New Mexico	Provide engineering services	D. H. Blair
2	8 3	Lukens Medical	New Mexico	Mnfr medical supplies	Commonwealth Associates
	12.3				
1	1 9	Global Spill Management	New York	Pvd waste disposal services	J. Gregory & Company
2	10 4	MedSonic	New York	Mnfr medical testing equipment	Josephthal Lyon & Ross, Inc
3	107 2	Infinity Broadcasting	New York	Own and operate radio stations	Lehman Brothers
4	11 6	Just Toys	New York	Mnfr games,toys,athletic equip	Gruntal
5	14 4	Ampex	New York	Mnfr sound recording equip	Lehman Brothers
6	143 5	Chicago and North Western Hldg	New York	Railroad holding company	Donaldson, Lufkin & Jenrette
7	166 4	Minerals Technologies	New York	Manufacture specialty minerals	Lazard Freres & Co
8	17 1	Ultralife Batteries, Inc.	New York	Mnfr dry,wet cell batteries	Pennsylvania Merchant Group
9	18 0	Financial Federal	New York	Provide equipment leasing svcs	PaineWebber
10	18 7	Peak Technologies Group	New York	Whl computers, peripherals	William Blair
11	2 0	Blue Chip Computerware	New York	Operate computer stores	Hanover Sterling & Company
12	20 0	Trinity Capital Opportunity	New York	Venture capital firm	GKN Securities Corp
13	21 0	Arbor National Holdings	New York	Mortgage bank holding company	Oppenheimer
14	21 0	Granite Broadcasting	New York	Operate radio, TV stations	Alex. Brown & Sons
15	21 5	Quantum Restaurant Group	New York	Own,operate restaurants	Lehman Brothers
16	25 7	RHI Entertainment	New York	Own film and TV library	Donaldson, Lufkin & Jenrette

1992 U.S. INITIAL PUBLIC OFFERINGS (IPOs)

(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
17	264 0	General Instrument	New York	Mnfr cable TV equipment	Goldman, Sachs
18	29 0	Galey & Lord	New York	Mnfr printed cotton fabrics	Donaldson, Lufkin & Jenrette
19	3 5	Bitwise Designs	New York	Manufacture personal computers	Berkeley International Capital
20	3 6	Gotham Apparel	New York	Mnfr lace,warp knit fabrics	S. D. Cohn
21	30 0	Health Management Systems	New York	Pvd data processing services	Merrill Lynch & Co.
22	315 0	Equitable Companies	New York	Life insurance company	Goldman, Sachs
23	35 1	USA Classic, Inc.	New York	Manufacture sportswear	PaineWebber
24	39 0	Danskin	New York	Manufacture dance apparel	Stephens
25	392 3	Ultramar	New York	Whl,refine petroleum products	Goldman, Sachs
26	4 0	Aerial Assault	New York	Manufacture footwear	Oak Ridge Investments
27	4 3	Pet Products	New York	Mnfr chewable rawhide dog trts	A S. Goldmen & Company
28	4 4	North American Recycling	New York	Waste to-energy recycling svcs	Tamaron Investments, Inc
29	4 9	Natural Child Care	New York	Mnfr surgical supplies	Continental Broker-Dealer Corp
30	462 0	Coltec Industries	New York	Automotive, aerospace prods	Morgan Stanley
31	48 6	The Student Loan Corporation	New York	Pvd personal credit services	Smith Barney, Harris Upham
32	5 0	CPI Aerostructures	New York	Mnfr aircraft parts,equipment	Whale Securities
33	5 0	DiversiFax	New York	Operate vending machines	R. F. Lafferty
34	5 3	Odd's-N-End's	New York	Operate general stores	Craig-Hallum, Inc.
35	5 5	Paracelsian	New York	Biological research services	Hampshire Securities
36	5 6	Hungarian Telephone and Cable	New York	Pvd telephone commun services	J.W. Barclay
37	6 0	Hi-Tech Pharmacal	New York	Mnfr pharmaceutical products	Laidlaw Equities
38	6 3	Laser Video Network	New York	Operate video games halls	D. H. Blair
39	7 2	RCL Acquisition	New York	Investment firm	RAS Securities Corporation
40	77 6	Enhance Financial Services	New York	Provide reinsurance brkg svcs	Salomon Brothers
41	770 0	First Data	New York	Provide data processing svcs	Lehman Brothers
42	8 0	Sayett Group	New York	Mnfr computer peripherals	Thomas James Associates
43	80 0	Snapple Holding	New York	Produce soft drinks	Merrill Lynch & Co.
44	83 1	PennCorp Financial Group	New York	Provide life,accident ins svcs	Smith Barney, Harris Upham
45	85 5	Scholastic Corporation	New York	Publish children's books	Goldman, Sachs
46	85 8	Capital Re	New York	Reinsurance company	Goldman, Sachs
47	87 0	Wellsford Residential Property	New York	Real estate investment trust	Merrill Lynch & Co.
48	88 0	Noel Group	New York	Investment firm	Lehman Brothers
	3671.0				

1992 U.S. INITIAL PUBLIC OFFERINGS (IPOs)

(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
1	10 4	Broadway & Seymour	North Carolina	Develop financial info systems	Robertson Stephens
2	20 0	Medic Computer Systems	North Carolina	Develop medical software	Alex. Brown & Sons
3	23 0	Lida	North Carolina	Mnfr lightweight fabrics	Lehman Brothers
4	37 8	American Studios	North Carolina	Portrait photography services	Robinson-Humphrey
5	4 3	Vital Living Products	North Carolina	Mnfr food processing equipment	J. W. Gant & Associates
6	469 4	Burlington Industries Equity	North Carolina	Investment firm	Morgan Stanley
7	48 0	Cone Mills	North Carolina	Mnfr fabrics and foam products	Prudential Securities Inc.
8	59 4	Monk-Austin	North Carolina	Whl leaf,processed tobacco	First Boston
9	75 0	Sphinx Pharmaceuticals	North Carolina	Mnfr pharmaceuticals products	Lehman Brothers
10	99 1	Integon	North Carolina	Insurance holding company	Smith Barney, Harris Upham
	846.4				
1	105 6	Capitol American Financial	Ohio	Accident,health ins svcs	Alex. Brown & Sons
2	13 1	Providence Health Care	Ohio	Own and operate nursing homes	Commonwealth Associates
3	14 0	Steris	Ohio	Manufacture sterilization sys	Robertson Stephens
4	19 6	CitFed Bancorp	Ohio	Bank holding company	Salomon Brothers
5	190 0	Scotts	Ohio	Mnfr fertilizers and tools	Goldman, Sachs
6	2 7	Future Healthcare	Ohio	Provide home health care svcs	Glaser Capital Corp
7	21 0	Worthington Foods	Ohio	Produce egg substitutes	William Blair
8	240 9	Reliance Electric	Ohio	Mnfr electric motor,generators	Goldman, Sachs
9	42 2	Chart Industries	Ohio	Mnfr fabricated plate work	County NatWest Securities Ltd
10	77 0	Hook-SupeRx	Ohio	Own and operate drug stores	Goldman, Sachs
11	8 8	Pomeroy Computer Resources	Ohio	Operate computer stores	First of Michigan
12	9 0	Neoprobe	Ohio	Mnfr surgery probes	GKN Securities Corp
	743.9				
1	120 0	Purolator Products	Oklahoma	Mnfr oil, fuel and air filters	Lehman Brothers
1	30 3	Protocol Systems	Oregon	Mnfr patient monitors	First Boston
2	7 2	Applied Laser Systems	Oregon	Manufacture semiconductors	D. H. Blair
	37.5				
1	11 9	Enzymatics	Pennsylvania	Manufacture diagnostic tests	Wertheim Schroder
2	115 2	USX Delhi Group	Pennsylvania	Natural gas transmission,distn	Lehman Brothers
3	12 0	Affinity Biotech	Pennsylvania	Mnfr pharmaceutical products	Pennsylvania Merchant Group

1992 U.S. INITIAL PUBLIC OFFERINGS (IPOs)

(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
4	12 0	Medrad	Pennsylvania	Mnfr medical instruments	Parker/Hunter
5	128 0	Kranzco Realty Trust	Pennsylvania	Real estate investment trust	Smith Barney, Harris Upham
6	138 6	CMAC Investment	Pennsylvania	Mtg insurance holding company	Lehman Brothers
7	22 5	Zynaxis	Pennsylvania	Biotechnological dvlp svcs	Pennsylvania Merchant Group
8	26 0	Menley & James	Pennsylvania	Mnfr,whl pharmaceuticals	Smith Barney, Harris Upham
9	33 8	MB Communications	Pennsylvania	Mnfr communications equipment	Donaldson, Lufkin & Jenrette
10	36 0	Arrow International	Pennsylvania	Manufacture medical equipment	Morgan Stanley
11	41 6	RehabClinics	Pennsylvania	Operate rehabilitation clinics	Robertson Stephens
12	5 0	Nutrition Management Services	Pennsylvania	Operate weight loss clinics	Stratton Oakmont Inc.
13	5 4	GraceCare Health Systems	Pennsylvania	Own and operate nursing homes	Royce Investments
14	6 0	SMT Health Services	Pennsylvania	Operate outpatient facilities	Stratton Oakmont Inc.
15	63 8	AdvaCare	Pennsylvania	Information retreival services	Robertson Stephens
16	70 0	Tocor II Inc	Pennsylvania	Develop pharmaceutical prods	PaineWebber
	727.8				
1	115 6	GTECH Holdings	Rhode Island	Mnfr computer terminals	Donaldson, Lufkin & Jenrette
2	200 0	Sunbeam-Oster	Rhode Island	Manufacture small appliances	Merrill Lynch& Co.
3	24 8	CytoTherapeutics	Rhode Island	Research chronic diseases	Robertson Stephens
4	30 8	Holson Burnes Group	Rhode Island	Manufacture photo albums	Lehman Brothers
	371.2				
1	161 0	Fleet Mortgage Group	South Carolina	Provide mortgage banking svcs	Goldman, Sachs
2	16 5	Dial Page	South Carolina	Beeper commun,rental services	Alex. Brown & Sons
3	32 0	Kemet	South Carolina	Mnfr tantalum capacitors	Donaldson, Lufkin & Jenrette
4	9 5	Hampshire Group	South Carolina	Knit outerwear mills	Advest
	219.0				
1	14 6	Varsity Spirit	Tennessee	Cheerleader training svcs	Morgan Keegan
2	15 2	Tapistron International	Tennessee	Mnfr textile ind machinery	Josephthal Lyon & Ross, Inc.
3	16 1	ImageAmerica	Tennessee	Operate medical imaging ctr	Dean Witter Reynolds
4	25 2	Krystal	Tennessee	Operate fast food restaurants	Dean Witter Reynolds
5	26 3	Shoney's	Tennessee	Own and operate restaurants	J. C. Bradford
6	29 4	Midland Financial Group	Tennessee	Fire, marine,casualty ins co	Robinson Humphrey
7	317 6	Arcadian Partners	Tennessee	Mnfr phosphatic fertilizers	Lehman Brothers
8	37 6	PhyCor	Tennessee	Operate testing laboratories	Alex. Brown & Sons
9	41 4	Dyersburg	Tennessee	Manufacture cotton fabrics	First Boston

1992 U.S. INITIAL PUBLIC OFFERINGS (IPOs)
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	$ Millions	Company	State	Business	Underwriter
10	52 2	Fred's	Tennessee	Operate department stores	Robinson-Humphrey
11	584 8	HCA Hospital Corp of America	Tennessee	Hospital, medical facilities	Goldman, Sachs
12	87 4	Maybelline	Tennessee	Mnfr perfumes and cosmetics	Merrill Lynch & Co
	1247.8				
1	10 8	Sterling Bancshares, Inc	Texas	Bank holding company	Legg Mason Wood Walker
2	11 5	On The Border Cafes, Inc.	Texas	Operate Tex-Mex restaurants	The Principal/Eppler, Guerin
3	11 9	Argus Pharmaceutical	Texas	Mnfr pharmaceutical products	S G. Warburg Securities Corp
4	112 8	Living Centers of America	Texas	Provide rehabilitation svcs	Merrill Lynch & Co
5	13 5	Encore Wire	Texas	Manufacture copper wire	A G Edwards & Sons
6	130 0	Enron Liquids Pipeline	Texas	Operate natural gas pipelines	Lehman Brothers
7	147 2	ElectroCom Automation	Texas	Mnfr electronic components	Merrill Lynch & Co
8	15 7	HCC Insurance Holdings	Texas	Property,casualty insurance co	William Blair
9	15 8	Liliequest Medical	Texas	Mnfr vascular access devices	Kemper Securities
10	16 1	Ace Cash Express	Texas	Provide check cashing services	The Principal/Eppler, Guerin
11	16 6	NCI Building Systems	Texas	Mnfr prefabricated warehouses	Rauscher Pierce Refsnes
12	17 1	Optical Data Systems	Texas	Mnfr computer optical scanners	Prudential Securities Inc
13	17 6	NetWorth	Texas	Mnfr networking equipment	Robertson Stephens
14	18 0	American Funeral Services	Texas	Real estate development firm	Raymond James & Associates
15	19 5	Men's Wearhouse	Texas	Operate men's apparel store	Bear, Stearns
16	23 4	Data Race	Texas	Mnfr telecommunications equip	Raymond James & Associates
17	23 4	Whole Foods Markets	Texas	Own and operate supermarkets	Robertson Stephens
18	26 7	Celebrity	Texas	Whl artificial flowers	Rauscher Pierce Refsnes
19	27 6	VideoTelecom	Texas	Mnfr video telecommun equip	Montgomery Securities
20	28 1	Coastal Banc Savings Assn	Texas	Savings and loan	Kidder, Peabody
21	30 0	Cross Timbers Royalty Trust	Texas	Oil and gas exploration, prodn	Goldman, Sachs
22	31 2	Solo Serve	Texas	Operate department stores	Goldman, Sachs
23	35 2	Hall Mark Electronics	Texas	Mnfr electronic components	Lehman Brothers
24	36 5	Taco Cabana	Texas	Own,op mexican patio cafe	Montgomery Securities
25	38 0	First USA	Texas	Securities brokerage firm	Merrill Lynch & Co
26	4 9	Smith's Oil Field Services	Texas	Provide oil field services	Gaines, Berland
27	44 2	DR Horton	Texas	Residential construction svcs	Lehman Brothers
28	44 4	Nu Kote Holding	Texas	Mnfr printer ribbons	First Boston
29	46 2	Haggar	Texas	Mnfr, whl men's apparel	Goldman, Sachs
30	5 0	Billy Blues Food	Texas	Operate TX style restaurants	Noble Investment Co

1992 U.S. INITIAL PUBLIC OFFERINGS (IPOs)

(Source: Securities Data Company -- excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
31	5 5	Aquanatural	Texas	Mnfr food products machinery	Stratton Oakmont Inc
32	5 9	Industrial Holdings	Texas	Industrial real estate hldgs	Texas Capital Securities
33	54 7	Morningstar Group	Texas	Produce dairy products	First Boston
34	6 1	Universal Seismic Associates	Texas	Seismic exploration services	Texas Capital Securities
35	7 0	Lifecell	Texas	Mnfr tissue preservation prods	Robert Todd Financial Corp
36	7 2	3CI Complete Compliance	Texas	Trucking company	Laidlaw Equities
37	7 5	United States Physical Therapy	Texas	Provide home health care svcs	RAS Securities Corporation
38	76 0	El Paso Natural Gas	Texas	Gas utility, production	Morgan Stanley
39	8 4	Amber's Stores	Texas	Own,op arts and crafts stores	The Principal/Eppler, Guerin
	1197.2				
1	17 5	Agridyne Technologies	Utah	Manufacture insecticides	Piper, Jaffray & Hopwood
2	27 5	CardioPulmonics	Utah	Manufacture medical products	Piper, Jaffray & Hopwood
3	62 0	Franklin Quest	Utah	Manufacture notebooks	Merrill Lynch & Co.
4	9 4	TheraTech	Utah	Develop drug delivery systems	William Blair
	116.4				
1	120 0	Intl Family Entertainment	Virginia	Provide cable television svcs	Donaldson, Lufkin & Jenrette
2	212 8	First Colony Corporation	Virginia	Insurance holding company	First Boston
3	23 0	America Online	Virginia	Provide info retrieval svcs	Alex Brown & Sons
4	3 9	RailAmerica	Virginia	Railroad company	J W Charles Securities
5	33 0	Netrix	Virginia	Manufacture commun equipment	Alex Brown & Sons
6	4 0	Evergreen Information Tech	Virginia	Provide info retrieval svcs	Rocky Mountain Securities & In
7	49 7	Eskimo Pie	Virginia	Wholesale ice cream products	Wheat First Butcher & Singer
8	6 0	Network Imaging	Virginia	Mnfr image processing equip	Thomas James Associates
	452.4				
1	35 7	Starbucks	Washington	Own and operate coffee stores	Alex Brown & Sons
2	4 9	Columbia Banking System	Washington	Bank holding company	Dain Bosworth
3	42 0	Eagle Hardware & Garden	Washington	Operate hardware stores	Montgomery Securities
4	68 4	Heart Technology	Washington	Manufacture heart catheters	Hambrecht & Quist
	151.0				

1992 U.S. INITIAL PUBLIC OFFERINGS (IPOs)

(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
1	108 4	Kohl's	Wisconsin	Operate department stores	Morgan Stanley
2	129 2	Rexnord	Wisconsin	Mnfr ball, roller bearings	Donaldson, Lufkin & Jenrette
3	28 6	Swing-N-Slide	Wisconsin	Mnfr backyard swings,slides	William Blair
4	90 4	Sybron	Wisconsin	Dental equipment and supplies	Donaldson, Lufkin & Jenrette
	356 6				
1	10 5	Ezcony Interamerica	Foreign	Wholesale consumer electronics	First Equity Corp of Florida
2	135 0	Enterprise Oil	Foreign	Oil and gas exploration, prodn	Lehman Brothers
3	142 8	Empresas ICA	Foreign	Highway construction services	Morgan Stanley
4	15 2	British Bio-Technology	Foreign	Mnfr pharmaceutical products	Morgan Stanley
5	16 2	SOFTIMAGE	Foreign	Whl 3 D visualization software	Hambrecht & Quist
6	17 0	Intertape Polymer Group	Foreign	Manufacture plastic products	Dean Witter Reynolds
7	18 9	LanOptics	Foreign	Mnfr wiring concentrators	Furman Selz Inc
8	236 3	Alcatel Alsthom CGE	Foreign	Mnfr telephone,comm apparatus	Morgan Stanley
9	24 6	4th Dimension Software	Foreign	Develop computer software	Lehman Brothers
10	28 2	Ortholix International	Foreign	Mnfr medical equipment	Alex. Brown & Sons
11	29 5	Corel	Foreign	Dvlp illustration software	Morgan Stanley
12	3 9	Spectral Diagnostics	Foreign	Manufacture diagnostic tests	Texas Securities Inc
13	30 2	ISG Technologies	Foreign	Dvlp computerized work station	Smith Barney, Harris Upham
14	30 3	Teledata Communication	Foreign	Mnfr telephone apparatus	Lehman Brothers
15	307 1	Waste Management Intl	Foreign	Provide waste management svcs	Merrill Lynch & Co.
16	33 4	Sapiens International	Foreign	Develop software	Oppenheimer
17	4 0	Cantab Pharmaceuticals	Foreign	Manufacture pharmaceuticals	PaineWebber
18	46 1	Creative Technology	Foreign	Mnfr computer peripheral equip	Goldman, Sachs
19	46 5	Tommy Hilfiger	Foreign	Mnfr,whl men's sportswear	Morgan Stanley
20	48 5	DSG International	Foreign	Mnfr specialty cleaning prods	Merrill Lynch & Co.
21	5 0	Edusoft	Foreign	Develop educational software	H J Meyers
22	5 3	Trinity Biotech	Foreign	Diagnostic whole blood tests	Dickinson & Co
23	50 9	Compania Cervecerias Unidas	Foreign	Produce beer and soft drinks	Nomura Securities Co Ltd
24	56 8	Transportacion Maritima	Foreign	Shipping company	Bear, Stearns
25	63 0	Neozyme II Corp/Genzyme Corp	Foreign	Research,development services	PaineWebber
26	71 5	BLADEX	Foreign	Bank	Oppenheimer
27	74 7	Halslund Nycomed	Foreign	Mnfr pharmaceutical,chem preps	Merrill Lynch & Co
28	75 6	Olicom	Foreign	Mnfr electrical equipment	Alex. Brown & Sons
29	8 1	ISG International Software	Foreign	Develop software	Pennsylvania Merchant Group

1992 U.S. INITIAL PUBLIC OFFERINGS (IPOs)
(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
30	80.0	Brilliance China Automotive	Foreign	Mnlr,wholesale minibuses	First Boston
31	80.3	Banco Comercial Portugues	Foreign	Bank	Merrill Lynch & Co
32	81.2	Tadiran	Foreign	Mnlr telephone equipment	Merrill Lynch & Co
33	92.8	Aracruz Celulose	Foreign	Provide forestry services	Salomon Brothers
34	1067.5	Wellcome Group	Foreign	Mnlr pharmaceuticals; hldg co	Morgan Stanley
	3036.9				

Note: Firm commitment underwritings of companies' common stock for which, prior to this offering, there was no public market; excludes mutual funds

1992 SECONDARY COMMON STOCK UNDERWRITINGS

Deals	$ Millions	Home of Issuer
4	158.4	Alabama
5	164.9	Arizona
1	59.3	Arkansas
71	2842.5	California
14	359.2	Colorado
13	1473.3	Connecticut
1	17.9	D. of Columbia
1	97.0	Delaware
22	920.9	Florida
10	649.4	Georgia
3	104.9	Idaho
19	1366.7	Illinois
6	249.9	Indiana
2	82.0	Iowa
2	81.5	Kansas
3	32.3	Kentucky
4	666.8	Louisiana
2	63.0	Maine
16	1006.3	Maryland
23	957.0	Massachusetts
15	2539.8	Michigan
20	1055.8	Minnesota
1	2.0	Mississippi
4	503.7	Missouri
1	55.0	Montana
2	59.0	Nebraska
6	396.1	Nevada
3	237.8	New Hampshire
23	833.0	New Jersey
1	30.1	New Mexico
38	4936.5	New York
8	756.1	North Carolina
1	1.3	North Dakota
14	1014.6	Ohio
4	221.5	Oklahoma
4	240.0	Oregon
24	2076.4	Pennsylvania
2	242.4	Rhode Island
4	215.2	South Carolina
8	310.5	Tennessee
48	3404.8	Texas
3	23.2	Utah
1	33.6	Vermont
10	472.3	Virginia
6	165.0	Washington
7	338.6	Wisconsin
1	11.1	Puerto Rico
14	2043.2	Foreign
495	33571.8	TOTAL

Note: Includes firm committment underwritings of common stock of companies whose stock is already publicly traded; excludes mutual funds.

1992 SECONDARY COMMON STOCK UNDERWRITINGS

(Source: Securities Data Company -- excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
1	33 6	ReLife	Alabama	Operate physical rehab centers	J. C. Bradford
2	51 3	Birmingham Steel	Alabama	Manufacture steel, steel prod	Morgan Stanley
3	63 6	SouthTrust	Alabama	Bank holding company	Merrill Lynch & Co.
4	9 9	First Alabama Bancshares	Alabama	Bank holding company	Robinson-Humphrey
	158.4				
1	17 6	MicroAge	Arizona	Operate retail computer stores	Robinson-Humphrey
2	27 2	Pharmaceutical Marketing Svcs	Arizona	Pvd marketing support svcs	Lehman Brothers
3	29 3	Swift Transportation	Arizona	Trucking transp svcs;hldg co	Alex. Brown & Sons
4	43 5	Megafoods Stores	Arizona	Own and operate supermarkets	PaineWebber
5	47 3	Artisoft	Arizona	Mnfr networking equipment	Alex. Brown & Sons
	164.9				
1	59.3	JB Hunt Transport Services	Arkansas	Trucking company	Merrill Lynch & Co.
1	10 0	VISX	California	Mnfr surgical instruments	Allen & Co
2	10 1	Davstar Industries	California	Manufacture medical equipment	Paulson Investment
3	10 1	Nahama & Weagant Energy	California	Oil and gas exploration, prodn	Howard, Weil, Labouisse
4	10 9	Charter Golf	California	Wholesale golf equipment	Hanifen, Imhoff
5	102 6	MGM Grand	California	Operate hotels and airlines	Bear, Stearns
6	105 0	Pyxis Corporation	California	Provide med equip leasing svcs	Merrill Lynch & Co.
7	107 8	BWIP Holding	California	Mnfr fluid transfer equip	Goldman, Sachs
8	109 1	Foundation Health	California	Own and operate HMO's	Alex. Brown & Sons
9	11 3	Fidelity National Financial	California	Title insurance company	Oppenheimer
10	11 7	Biomagnetic Technologies	California	Mnfr medical imaging equipment	PaineWebber
11	131 6	Read-Rite	California	Mnfr computer storage devices	Goldman, Sachs
12	142 7	Countrywide Credit Industries	California	Provide mortgage banking svcs	Merrill Lynch & Co.
13	15 3	DVI Health Services	California	Provide financial services	Chicago Corporation
14	18 0	Calgene	California	Produce agricultural seeds	PaineWebber
15	18 0	GranCare	California	Own and operate nursing homes	Kidder, Peabody
16	2 0	Compumed	California	Mnfr electromedical equipment	Paulson Investment
17	2 4	Natural Alternatives Intl	California	Manufacture pharmaceuticals	Cohig & Associates
18	22.0	Benton Oil and Gas	California	Oil and gas exploration, prodn	S. G. Warburg Securities Corp.
19	22 5	Cygnus Therapeutic Systems	California	Mnfr drug delivery system	Robertson Stephens
20	24 2	Insurance Auto Auctions	California	Wholesale used auto parts	William Blair

1992 SECONDARY COMMON STOCK UNDERWRITINGS

(Source: Securities Data Company -- excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
21	24 4	Total Pharmaceutical Care	California	Pharmaceutical care services	Smith Barney, Harris Upham
22	25 0	Zilog	California	Manufacture semiconductors	Alex. Brown & Sons
23	25 1	Foothill Group	California	Coml financing,equip leasing	Mabon, Nugent
24	25 6	Celtrix Pharmaceuticals	California	Manufacture pharmaceuticals	Robertson Stephens
25	25 9	Sierra On-Line	California	Computer games software svcs	Lehman Brothers
26	258 5	National Health Laboratories	California	Diagnostic laboratory services	First Boston
27	26 6	First Republic Bancorp	California	Savings and loan	Montgomery Securities
28	27.4	United States Filter	California	Hazardous waste mgmt services	Alex. Brown & Sons
29	28 0	Cholestech	California	Mnlr diagnostic test kits	Kemper Securities
30	28 1	Target Therapeutics	California	Mnlr,whl mini-surgical devices	Alex. Brown & Sons
31	28 5	Meris Laboratories	California	Own and operate clinical labs	Robertson Stephens
32	29 0	Advanced Tissue Sciences	California	Biological research services	Smith Barney, Harris Upham
33	3 2	Irvine Sensor	California	Infrared radiation sensors	Paulson Investment
34	32 0	Liposome Technology	California	Produce liposome products	Oppenheimer
35	33 0	Standard Pacific	California	Construct homes;mnlr furniture	Prudential Securities Inc.
36	33 1	Frame Technology	California	Computer programming services	Hambrecht & Quist
37	33 3	The First American Financial	California	Provide personal linace svcs	Smith Barney, Harris Upham
38	33 6	Nettrame Systems	California	Manufacture electn computers	Lehman Brothers
39	33 6	Salick Health Care	California	Kidney dialysis centers	Kidder, Peabody
40	33 8	Lam Research	California	Mnlr plasma etching equipment	Smith Barney, Harris Upham
41	34 1	Syquest Technology	California	Mnlr computer storage devices	Robertson Stephens
42	34 5	Somatix Therapy	California	Mnlr cell biology products	Robertson Stephens
43	36 8	Silicon Graphics	California	Manufacture computer systems	Morgan Stanley
44	37 8	Callaway Golf	California	Manufacture golf clubs	Montgomery Securities
45	4 0	Urethane Technologies	California	Manufacture plastic materials	Whale Securities
46	4 2	Redwood Empire Bancorp	California	Bank holding company	Van Kasper
47	41 3	Medco Research	California	Manufacture pharmaceuticals	Kemper Securities
48	43.5	Gilead Sciences	California	Provide research, dvlp svcs	Robertson Stephens
49	45 0	Adaptec	California	Data flow control components	Bear, Stearns
50	5 0	Unique Mobility	California	Mnlr auto parts	VTR Capital, Inc
51	5 5	American United Global	California	Mnlr gaskets,sealing devices	Laidlaw Equities
52	5 8	California Micro Devices	California	Mnlr electronic components	T. R. Winston
53	50 3	Vestar	California	Liposome-based drugs	Alex. Brown & Sons
54	52 9	Network General	California	Mnlr LAN analying equipment	Hambrecht & Quist
55	58 1	Pacificare Health Systems	California	Own and operate HMOs	PaineWebber

1992 SECONDARY COMMON STOCK UNDERWRITINGS

(Source: Securities Data Company -- excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
56	6 0	Conversion Industries	California	Waste-to-energy mgmt systems	Tamaron Investments, Inc
57	6 5	Syntro	California	Vaccines, specialty chemicals	Piper, Jaffray & Hopwood
58	6 8	Wet Seal	California	Own,op womens clothing stores	First Boston
59	60 0	TakeCare	California	Provide group hospitalization	First Boston
60	62 4	Merisel	California	Whl computer hardware,software	Robinson-Humphrey
61	67 2	Applied Materials	California	Mnlr wafer fabrication systems	Lehman Brothers
62	7 0	Kushner-Locke	California	Movie,TV film production co	Chatfield Dean
63	7 7	Advanced Medical	California	Mnlr pharmaceuticals	Kidder, Peabody
64	70 0	Applied Immune Sciences	California	Mnlr blood therapeutic systems	Montgomery Securities
65	70 4	Health Care Property Investors	California	Real estate investment trust	Merrill Lynch & Co.
66	72 0	Valence Technology	California	Mnlr rechargeable batteries	Montgomery Securities
67	76	Kaufman and Broad Home	California	Residential contractors	Smith Barney, Harris Upham
68	81 8	BWIP Holding	California	Mnlr fluid transfer equip	Goldman, Sachs
69	9	THQ	California	Develop software	Volpe & Covington
70	9 6	SafetyTek	California	Mnlr process control equipment	William K. Woodruff
71	96 3	Pacificare Health Systems	California	Own and operate HMOs	PaineWebber
	2842.5				
1	1 4	Information Solutions	Colorado	Wholesale computer systems	Kober Financial
2	10 8	Evergreen Resources	Colorado	Oil and gas exploration, prodn	John G. Kinnard
3	2 0	Communications World Intl Inc	Colorado	Own,op, electrn repair shops	Cohig & Associates
4	2 3	Generation 5 Technology	Colorado	Mnlr microcomputer systems	Cohig & Associates
5	2 6	Topro	Colorado	Manufacture industrial equip	Barclay Investments, Inc.
6	32 1	Hauser Chemical Research	Colorado	Chem,substance testing svcs	Dain Bosworth
7	34 4	Cellular	Colorado	Cellular telephone services	Lehman Brothers
8	38 0	Somatogen	Colorado	Dvlp human blood substitutes	Alex. Brown & Sons
9	5 0	Good Times Restaurants	Colorado	Own and operate restaurants	Cohig & Associates
10	5 3	American Educational Products	Colorado	Mnlr educational services	John G. Kinnard
11	50 0	Associated Natural Gas	Colorado	Gas utility	Dillon, Read
12	6 5	Cryenco Sciences	Colorado	Mnlr liquid gas storage tanks	Dain Bosworth
13	71 5	Gerrity Oil and Gas Corp	Colorado	Oil and gas exploration,prodn	Goldman, Sachs
14	97 3	Tele Communications	Colorado	Operate cable TV systems	Merrill Lynch & Co.
	359.2				

1992 SECONDARY COMMON STOCK UNDERWRITINGS
(Source: Securities Data Company -- excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
1	119 0	Value Health	Connecticut	Provide health svcs	Alex. Brown & Sons
2	15 6	Connecticut Natural Gas	Connecticut	Gas utility	A. G. Edwards & Sons
3	18 4	Forschner Group	Connecticut	Wholesale cutlery	Allen & Co
4	193 4	Northeast Utilities	Connecticut	Electric utility holding co	Morgan Stanley
5	21 3	Aquarion	Connecticut	Water supply company	Morgan Stanley
6	22.7	Yankee Energy System	Connecticut	Natural gas distrubution svcs	Bear, Stearns
7	33 5	Oxford Health Plans	Connecticut	HMO	Donaldson, Lufkin & Jenrette
8	44	Petroleum Heat and Power	Connecticut	Retail home heating oil	Kidder, Peabody
9	45 2	CUC International	Connecticut	Provide discount shopping svcs	Goldman, Sachs
10	6	VIMRx Pharmaceuticals	Connecticut	Manufacture pharmaceuticals	D. H. Blair
11	78 1	Value Health	Connecticut	Provide health svcs	Alex. Brown & Sons
12	789 0	GTE	Connecticut	Telecommunication services	PaineWebber
13	87 1	Crompton & Knowles	Connecticut	Mnfr chemicals, dyes, flavors	Salomon Brothers
	1473.3				
1	17.9	Harman Intl Industries	D. of Columbia	Loudspeakers, audio components	Montgomery Securities
1	97.0	EW Scripps	Delaware	Publish newspapers	First Boston
1	11 3	Oriole Homes	Florida	RE developer; home builder	PaineWebber
2	155 2	Sensormatic Electronics	Florida	Electronic surveillance equip	Lehman Brothers
3	17.5	Noven Pharmaceuticals	Florida	Provide coml lab research svcs	Mabon Securities Corp
4	186 3	FPL Group	Florida	Electric utility; Insurance	Lehman Brothers
5	2 3	Christian Purchasing Network	Florida	Investment advisory svcs	Donald & Co. Securities
6	20 4	Digital Products	Florida	Telephone,telegraph apparatus	Dickinson & Co
7	23 9	PMC Capital	Florida	Pvd general,indl credit svcs	Fahnestock
8	28 8	BE Aerospace	Florida	Mnfr aircraft parts,equipment	PaineWebber
9	29 3	Perfumania	Florida	Wholesale and retail perfumes	Dean Witter Reynolds
10	3 5	All American Semiconductor	Florida	Whl electronic components	J W Charles Securities
11	3 6	Acorn Venture Capital	Florida	Venture capital company	F. N. Wolf
12	33 5	Ramsay HMO	Florida	Own and operate HMOs	Merrill Lynch & Co
13	42 8	Lincare Holdings	Florida	Provide oxygen treatment svcs	Dean Witter Reynolds
14	5 0	Modami Services	Florida	Produce ice cream	Kennedy, Mathews, Landis
15	5 2	Florida Public Utilities Co	Florida	Electric and gas utility	Edward D. Jones

1992 SECONDARY COMMON STOCK UNDERWRITINGS

(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
16	50 5	Checkers Drive-In Restaurants	Florida	Operate drive-thru restaurants	Dean Witter Reynolds
17	6 0	Royce Laboratories	Florida	Mnlr pharmaceuticals products	Paradise Valley Securities Inc
18	66 0	Outback Steakhouse	Florida	Own and operate restaurants	Alex. Brown & Sons
19	67.9	Outback Steakhouse	Florida	Own and operate restaurants	Alex. Brown & Sons
20	68 3	Florida Progress	Florida	Electric utility holding co	Merrill Lynch & Co
21	8 1	Sheffield Industries	Florida	Manufacture hosiery	Vantage Securities
22	85 5	Barnett Banks	Florida	Bank holding company	Lehman Brothers
	920.9				
1	116 0	Shaw Industries	Georgia	Manufacture tufted carpets	Merrill Lynch & Co.
2	131.2	Georgia Gulf	Georgia	Mnlr indl chemicals, resins	Goldman, Sachs
3	147	Turner Broadcasting System	Georgia	Operate TV, cable TV stations	Merrill Lynch & Co.
4	25 3	Merry Land & Investment	Georgia	Real estate investment trust	Alex. Brown & Sons
5	25 5	Medaphis Corp	Georgia	Data processing services	Alex. Brown & Sons
6	25 9	Crown Crafts	Georgia	Mnlr quilted products	William Blair
7	33 6	National Vision Associates	Georgia	Operate optical goods stores	Robinson-Humphrey
8	39 5	Intermet	Georgia	Ductile, gray iron castings	Donaldson, Lufkin & Jenrette
9	50 4	Cousins Properties	Georgia	Real estate investment trust	Lazard Freres & Co.
10	55 0	IRT Property	Georgia	Real estate investment trust	Kidder, Peabody
	649.4				
1	14 0	BMC West	Idaho	Whl, ret bldg materials	Salomon Brothers
2	27 9	Idaho Power	Idaho	Electric utility	Merrill Lynch & Co.
3	63 0	West One Bancorp	Idaho	Bank holding company	Merrill Lynch & Co.
	104.9				
1	13.3	Intercargo	Illinois	Marine cargo insurance svcs	Kemper Securities
2	181.0	Illinois Central	Illinois	Own and operate railroad	Lehman Brothers
3	20 8	Material Sciences	Illinois	Mnlr coated and painted metals	Dillon, Read
4	229 3	First Chicago	Illinois	Bank holding company	First Boston
5	28 8	Information Resources	Illinois	Data base,market research svcs	Hambrecht & Quist
6	3 6	Information Resources	Illinois	Data base,market research svcs	Hambrecht & Quist
7	31 5	NuCorp	Illinois	Fire,marine, insurance company	Stephens
8	318 5	Santa Fe Pacific	Illinois	Op freight railroad lines	Merrill Lynch & Co.
9	40 0	Interlake	Illinois	Mnlr iron, steel, aerospace	Donaldson, Lufkin & Jenrette

1992 SECONDARY COMMON STOCK UNDERWRITINGS
(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
10	40 7	Fruit of the Loom	Illinois	Mnfr underwear and active wear	First Boston
11	47 7	Peoples Energy	Illinois	Pvd nat gas transmission svcs	Smith Barney, Harris Upham
12	5 0	Trans Leasing International	Illinois	Lease medical equipment	Ladenburg, Thalmann
13	50 1	Technology Solutions	Illinois	Computer consulting services	Goldman, Sachs
14	53 3	Telephone and Data Systems	Illinois	Telecommunications services	Donaldson, Lufkin & Jenrette
15	6 3	Princeton National Bancorp	Illinois	Bank holding company	Chicago Corporation
16	61 3	Bell Sports	Illinois	Manufacture bicycle parts	William Blair
17	75 6	Inland Steel Industries	Illinois	Steel manufacturing hldg co	Goldman, Sachs
18	78 9	Wisconsin Central	Illinois	Provide line-haul RR services	Goldman, Sachs
19	81	Brunswick	Illinois	Mnfr boats, sporting goods	Merrill Lynch & Co.
	1366.7				
1	12 5	Schult Homes	Indiana	Manufacture mobile homes	Chicago Corporation
2	19 5	Excel Industries	Indiana	Mnfr motor vehicle windows	Dean Witter Reynolds
3	24 4	Finish Line	Indiana	Athletic footwear ret stores	Oppenheimer
4	47 8	Wabash National	Indiana	Manufacture truck trailers	Alex Brown & Sons
5	54 5	Arvin Industries	Indiana	Mnfr auto parts, accessories	Merrill Lynch & Co
6	91 2	Cummins Engine	Indiana	Manufacture diesel engines	Morgan Stanley
	249 9				
1	27 8	Allied Group, Inc.	Iowa	Insurance holding company	Alex Brown & Sons
2	54 2	Iowa-Illinois Gas & Electric	Iowa	Electric and gas utility	Goldman, Sachs
	82 0				
1	72 5	Lone Star Steakhouse & Saloon	Kansas	Own and operate restaurants	Montgomery Securities
2	9 0	Collins Industries	Kansas	Wheelchair lifts and vehicles	George K Baum
	81.5				
1	12 6	Rally's	Kentucky	Own,op drive-through rests	Montgomery Securities
2	16 2	Trans Financial Bancorp	Kentucky	Bank holding company	Morgan Keegan
3	3 5	Skolniks	Kentucky	Operate, franchise restaurants	American Trading & Investments
	32.3				

1992 SECONDARY COMMON STOCK UNDERWRITINGS
(Source: Securities Data Company -- excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
1	136 5	Freeport-McMoRan Copper & Gold	Louisiana	Copper mining company,hldg co	Kidder, Peabody
2	402 5	Freeport McMoRan Resource	Louisiana	Sulphur, phosphate, uranium	Merrill Lynch & Co
3	47 8	First Commerce	Louisiana	Bank holding company	Keefe, Bruyette & Woods
4	80 0	Hibernia	Louisiana	Bank holding company	Dillon, Read
	666.8				
1	30 8	IDEXX Laboratories	Maine	Mnfr biotech detection systems	Lehman Brothers
2	32 2	Peoples Heritage Financial	Maine	Savings bank	Keefe, Bruyette & Woods
	63.0				
1	10 0	Crop Genetics International	Maryland	Mnfr microbial pesticides	Alex. Brown & Sons
2	10 1	R O C Taiwan Fund	Maryland	Closed-end investment fund	First Boston
3	10 4	Swiss Helvetia Fund	Maryland	Closed-end mutual fund	NON-UNDERWRITTEN
4	14 8	Hanger Orthopedic Group	Maryland	Pvd orthopedic medical svcs	PaineWebber
5	141 8	Baltimore Gas and Electric	Maryland	Electric and gas utility	Merrill Lynch & Co.
6	146 0	Baltimore Gas and Electric	Maryland	Electric and gas utility	Merrill Lynch & Co.
7	15 4	Cosmetic Center	Maryland	Operate cosmetic stores	Legg Mason Wood Walker
8	22 5	Genetic Therapy	Maryland	Develop delivery systems	Smith Barney, Harris Upham
9	23 9	Resource Mortgage Capital	Maryland	Mortgage securities finance co	Lehman Brothers
10	31 5	Oncor	Maryland	Mnfr biological products	Smith Barney, Harris Upham
11	334 8	The Black & Decker	Maryland	Mnfr power driven tools	Lehman Brothers
12	34 0	Nova Pharmaceutical	Maryland	Pharmaceutical research svcs	Tucker Anthony
13	40 8	Washington Real Estate Inv Tr	Maryland	Real estate investment trust	Alex. Brown & Sons
14	47 5	Integrated Health Services	Maryland	Operate geriatric care centers	Smith Barney, Harris Upham
15	61 3	Ryland Group	Maryland	Home general contractors	Kidder, Peabody
16	61 5	Federal Realty Invest Trust	Maryland	Real estate investment trust	Merrill Lynch & Co.
	1006.3				
1	10 5	Corporate Software	Massachusetts	Wholesale computer software	Donaldson, Lufkin & Jenrette
2	122 4	Bank of Boston	Massachusetts	Bank holding company	Merrill Lynch & Co.
3	13 0	Farragut Mortgage	Massachusetts	Mortgage bank	Paulson Investment
4	18 1	Thermo Cardiosystems	Massachusetts	Mnfr heart monitoring systems	Lehman Brothers
5	180 0	Shawmut National	Massachusetts	Bank holding company	Morgan Stanley
6	26 9	Au Bon Pain	Massachusetts	Own and opeate bakery cafes	Morgan Stanley
7	28 8	TSI	Massachusetts	Pvd preclinical testing svcs	Cowen

1992 SECONDARY COMMON STOCK UNDERWRITINGS
(Source: Securities Data Company -- excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
8	30 0	Bertucci's	Massachusetts	Own and operate restaurants	Montgomery Securities
9	33 0	Costar Corp	Massachusetts	Manufacture medical products	Alex Brown & Sons
10	34 1	Advanced Magnetics	Massachusetts	Medical diagnostic products	PaineWebber
11	36 0	Bay State Gas	Massachusetts	Gas transmission & distribtn	Smith Barney, Harris Upham
12	39 5	Ionics	Massachusetts	Mnfr water purification prods	PaineWebber
13	4 0	DynaGen	Massachusetts	Mnfr diagnostic substances	Thomas James Associates
14	4 4	Essex County Gas	Massachusetts	Gas utility	Edward D Jones
15	4 4	Precision Optics	Massachusetts	Mnfr optical instruments	Kennedy, Mathews, Landis
16	41 3	EMC	Massachusetts	Computer memory storage sys	Salomon Brothers
17	44 3	Bradley Real Estate Trust	Massachusetts	Real estate investment trust	Kidder, Peabody
18	45 5	ImmuLogic Pharmaceutical	Massachusetts	Mnfr biological products	Morgan Stanley
19	46 5	Designs	Massachusetts	Operate retail clothing stores	PaineWebber
20	52 3	Boston Edison	Massachusetts	Electric utility	Goldman, Sachs
21	63 0	Damon	Massachusetts	Clinical lab testing services	Bear, Stearns
22	7 0	BPI Environmental	Massachusetts	Mnfr unsupported plastics film	Thomas James Associates
23	72 0	BayBanks	Massachusetts	Bank holding co	Morgan Stanley
	957.0				
1	11 1	Donnelly	Michigan	Mnfr auto mirrors, windows	A. G. Edwards & Sons
2	11 1	Spartan Motors	Michigan	Operate auto dealerships	First of Michigan
3	13	Perry Drug Stores	Michigan	Retail drug, auto-home stores	Prudential Securities Inc.
4	131 2	Perrigo	Michigan	Pharmaceuticals, toiletries	Morgan Stanley
5	1560	General Motors	Michigan	Motor vehicles, accessories	Morgan Stanley
6	24 8	Simpson Industries	Michigan	Mnfr motor vehicle parts	Donaldson, Lufkin & Jenrette
7	26 4	Douglas & Lomason	Michigan	Wholesale motor vehicles	Bear, Stearns
8	29 3	Walbro	Michigan	Mnfr fuel system components	Stifel, Nicolaus
9	414 0	General Motors	Michigan	Motor vehicles, accessories	Merrill Lynch & Co
10	47 3	ALC Communications	Michigan	Long distance telecomm service	PaineWebber
11	54 0	Magna Group	Michigan	Bank holding company	Donaldson, Lufkin & Jenrette
12	59 7	MCN	Michigan	Natural gas distribution svcs	Merrill Lynch & Co
13	62 4	TriMas	Michigan	Mnfr specialty closures, caps	Lehman Brothers
14	8 7	Republic Bancorp	Michigan	Bank holding company	Keefe, Bruyette & Woods
15	86 8	RP Scherer	Michigan	Mnfr soft gelatin capsules	Lehman Brothers
	2539.8				

1992 SECONDARY COMMON STOCK UNDERWRITINGS
(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
1	10 4	Air-Cure Environmental	Minnesota	Mnfr air purification equip	Pennsylvania Merchant Group
2	108	Green Tree Acceptance	Minnesota	Finance mobile homes	Merrill Lynch & Co.
3	135 0	Amer Adjustable Rate Term 1999	Minnesota	Closed-end mutual fund	Piper, Jaffray & Hopwood
4	160	American Rate Term Tr 1998	Minnesota	Provide investment mgmt svcs	Piper, Jaffray & Hopwood
5	162 0	United HealthCare	Minnesota	Own and operate HMO's	Goldman, Sachs
6	191 4	Fingerhut Companies, Inc.	Minnesota	Operate mail-order catalog	Smith Barney, Harris Upham
7	2 3	Ultimap	Minnesota	Manufacture computer equipment	John G. Kinnard
8	2 9	CNS	Minnesota	Brain wave monitoring systems	Summit Investment
9	25 1	Inter-Regional Financial Group	Minnesota	Investment bank holding co	Smith Barney, Harris Upham
10	27 8	Hutchinson Technology	Minnesota	Computer peripheral components	Montgomery Securities
11	29 6	TCF Financial	Minnesota	Savings and loan	Piper, Jaffray & Hopwood
12	3 0	Education Alternatives	Minnesota	Educational consulting svcs	Dain Bosworth
13	3 6	Everest Medical	Minnesota	Mnfr electrosurgical devices	Miller, Johnson & Kuehn, Inc.
14	31 3	Olympic Financial	Minnesota	Provide loan brokerage svcs	Kidder, Peabody
15	38 1	Grand Casinos	Minnesota	Own and operate casinos	Ladenburg, Thalmann
16	46.1	NWNL Companies	Minnesota	Life insurance holding company	Goldman, Sachs
17	56 6	Piper Jaffray	Minnesota	Securities brokers; holding co	Morgan Stanley
18	6 5	Ultra Pac	Minnesota	Mnfr packaging material	Craig-Hallum, Inc
19	7 5	ImmunoTherapeutics	Minnesota	Pvd pharm research services	F. N. Wolf
20	8 6	Ringer	Minnesota	Mnfr whl fertilizers	Piper, Jaffray & Hopwood
	1055 8				
1	2.0	Worldwide Forest Products	Mississippi	Mnfr treated wooden products	Tamaron Investments, Inc
1	10 8	Falcon Products	Missouri	Mnfr furniture,wire prod	Raymond James & Associates
2	409 6	Marion Merrell Dow	Missouri	Manufacture pharmaceuticals	Merrill Lynch & Co.
3	41 3	Kellwood Co	Missouri	Mnfr apparel,camping equipment	First Boston
4	42 0	Applebee's International	Missouri	Operate, franchise restaurants	Piper, Jaffray & Hopwood
	503.7				
1	55.0	Video Lottery Technologies	Montana	Mnfr video lottery systems	Montgomery Securities

1992 SECONDARY COMMON STOCK UNDERWRITINGS
(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
1	24 0	American Business Information	Nebraska	Pvd bus to bus mktg info	Hambrecht & Quist
2	35 0	Commercial Federal	Nebraska	Savings & loan holding company	Montgomery Securities
	59.0				
1	159 8	Mirage Resorts	Nevada	Own and operate casino hotels	Salomon Brothers
2	36 1	Rio Hotel & Casino	Nevada	Own,operate casino hotel	Volpe, Welty & Company
3	47 1	Nevada Power	Nevada	Electric utility	PaineWebber
4	48 5	Bally Gaming International	Nevada	Manufacture gaming equipment	Salomon Brothers
5	51 2	Showboat	Nevada	Own and operate a hotel casino	Donaldson, Lufkin & Jenrette
6	53 4	American Pacific	Nevada	Mnfr industrial chemicals	Dean Witter Reynolds
	396.1				
1	113 8	Fisher Scientific Intl	New Hampshire	Mnfr lab supplies,chemicals	First Boston
2	117 2	Cabletron Systems	New Hampshire	Pvd LAN design,install svcs	Merrill Lynch & Co.
3	6 8	Hadco	New Hampshire	Mnfr computer circuit boards	Adams, Harkness & Hill
	237.8				
1	10 6	Interchange Financial Services	New Jersey	Bank holding company	Oppenheimer
2	122 1	Public Service Enterprise Grp	New Jersey	Electric and gas utility	Merrill Lynch & Co.
3	13 4	E'town	New Jersey	Water utility holding company	Kidder, Peabody
4	15 8	Commerce Bancorp	New Jersey	Bank holding company	Legg Mason Wood Walker
5	18 4	Hubco	New Jersey	Bank holding company	Bear, Stearns
6	26 3	Air & Water Technologies	New Jersey	Refuse systems,holding company	Allen & Co
7	28 0	Immunomedics	New Jersey	Mnfr in vivo imaging prod	Allen & Co
8	28 7	NUI	New Jersey	Retail liquefied petro gas	Dillon, Read
9	3 2	Base Ten Systems	New Jersey	Mnfr electronic defense sys	Shamrock Partners, Ltd
10	33 4	New Jersey Resources	New Jersey	Gas utility holding company	Merrill Lynch & Co.
11	34 3	Bisys Group	New Jersey	Provide data processing svcs	Lehman Brothers
12	36 9	Summit Bancorporation	New Jersey	Bank holding company	Merrill Lynch & Co.
13	4 6	Middlesex Water	New Jersey	Water distribution utility	Edward D. Jones
14	41 3	Liposome	New Jersey	Pharmaceutical products	Hambrecht & Quist
15	5 0	Bio-Imaging Technologies	New Jersey	Manufacture surgical equipment	GKN Securities Corp
16	54 0	Applied Bioscience Intl	New Jersey	Biological testing services	Lehman Brothers
17	60 8	UJB Financial	New Jersey	Bank holding company	Merrill Lynch & Co.
18	62 7	Fleer	New Jersey	Produce candy and gum	Merrill Lynch & Co.

1992 SECONDARY COMMON STOCK UNDERWRITINGS
(Source: Securities Data Company -- excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
19	7 2	Great American Recreation	New Jersey	Own and operate ski resorts	Dickinson & Co
20	72 0	Constellation Bancorp	New Jersey	Bank holding company	Keefe, Bruyette & Woods
21	72.1	Citizens First Bancorp	New Jersey	Bank holding company	Ladenburg, Thalmann
22	73 5	Thomas & Betts	New Jersey	Mnfr electrical components	Morgan Stanley
23	8 7	Great American Recreation	New Jersey	Own and operate ski resorts	Dickinson & Co
	833.0				
1	30.1	Mesa Airlines	New Mexico	Passenger airline	Bear, Stearns
1	100 0	Sotheby's Holdings	New York	Provide auctioning, RE svcs	Lazard Freres & Co.
2	109 9	Forest Laboratories	New York	Manufacture pharmaceuticals	Lehman Brothers
3	12 0	Stall Builders	New York	Pvd home health care services	Whale Securities
4	122 6	New York State Electric & Gas	New York	Electric and gas utility	Merrill Lynch & Co.
5	1226 3	Chemical Banking	New York	Bank holding company	Goldman, Sachs
6	131 5	Mexico Fund	New York	Closed-end investment fund	NON-UNDERWRITTEN
7	138	Warnaco Group	New York	Mnfr women's intimate apparel	Morgan Stanley
8	148 3	Consolidated Edison	New York	Electric,gas and steam utility	Merrill Lynch & Co.
9	192 0	Reader's Digest Association	New York	Publish magazines and books	Goldman, Sachs
10	2 3	MarkitStar	New York	Mnfr comp marketing systems	NON-UNDERWRITTEN
11	21 5	US HomeCare	New York	Provide home health care svcs	Robertson Stephens
12	21 9	Trans World Music	New York	Retail records, video cassette	Goldman, Sachs
13	23 5	Paxar Corporation	New York	Manufacture labels	Bear, Stearns
14	241.6	Bank of New York	New York	Bank holding company	Goldman, Sachs
15	3 0	Lancit Media Productions	New York	Produce children's TV shows	GKN Securities Corp
16	3 0	News Communications	New York	Publish newspapers,magazines	Hibbard Brown & Company
17	3 7	All-Quotes	New York	Provide stock quotation svcs	American Bond Group, Inc
18	318 5	MBIA	New York	Municipal bond insurance co	Donaldson, Lufkin & Jenrette
19	358	Amerada Hess Corp	New York	Oil, gas prodn and refining	Goldman, Sachs
20	36 6	Quantum Restaurant Group	New York	Own,operate restaurants	Lehman Brothers
21	38 5	PEC Israel Economic	New York	Investment firm	Lehman Brothers
22	4 1	Micro Bio Medics	New York	Wholesale medical equipment	Royce Investments
23	40 7	SLM International	New York	Manufacture sporting goods	Kidder, Peabody
24	41 0	Canandaigua Wine	New York	Produce wines	Bear, Stearns
25	42 0	Rochester Gas and Electric	New York	Electric and gas utility	Smith Barney, Harris Upham
26	43 1	United States Banknote	New York	Sec document printing services	Bear, Stearns

1992 SECONDARY COMMON STOCK UNDERWRITINGS
(Source: Securities Data Company -- excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
27	442 0	AMBAC	New York	Financial guaranty ins svcs	Morgan Stanley
28	465 6	International Paper	New York	Mnfr paper and lumber prods	First Boston
29	5 9	Homecare Management	New York	Provide home health care svcs	Commonwealth Associates
30	50 8	Kimco Realty	New York	REIT; operate commercial RE	Merrill Lynch & Co
31	57 6	Arrow Electronics	New York	Whl electric,comp components	Morgan Stanley
32	6 0	All American Communications	New York	Distribute TV programs	Seidler Amdec Securities
33	63 4	New Plan Realty Trust	New York	Real estate investment trust	Merrill Lynch & Co
34	69 1	National Fuel Gas	New York	Gas utility holding company	Merrill Lynch & Co.
35	81 0	Allegheny Power System	New York	Electric utility holding co	Goldman, Sachs
36	82 3	MBIA	New York	Municipal bond insurance co	Donaldson, Lufkin & Jenrette
37	90 2	Varity	New York	Mnfr agricultural tractors	Smith Barney, Harris Upham
38	99 0	Phillips-Van Heusen	New York	Manufacture mens apparel	Goldman, Sachs
	4936.5				
1	270	NationsBank	North Carolina	Bank hldg co, financial svcs	Merrill Lynch & Co.
2	17 0	Health Equity Properties Inc	North Carolina	Real estate investment trust	County NatWest Securities Ltd
3	17 7	PCA International	North Carolina	Provide family portrait svcs	William Blair
4	253 7	First Union	North Carolina	Bank holding compoany	Goldman, Sachs
5	26 6	Fieldcrest Cannon	North Carolina	Own,op broadwoven fabric mills	Kidder, Peabody
6	28 1	Cato	North Carolina	Women's apparel retail stores	Robertson Stephens
7	49 5	LADD Furniture	North Carolina	Mnfr household furniture	Dillon, Read
8	93 5	Integon	North Carolina	Insurance holding company	Smith Barney, Harris Upham
	756.1				
1	1.3	Fronteer Directory	North Dakota	Publish directories	RAF Financial
1	10 0	Waxman Industries	Ohio	Mnfr plumbing, elec products	Kidder, Peabody
2	110 0	Revco DS	Ohio	Own,op retail drugs stores	NON-UNDERWRITTEN
3	121 5	Progressive	Ohio	Insurance holding company	Bear, Stearns
4	137 6	Dana	Ohio	Mnfr motor vehicle products	Merrill Lynch & Co.
5	17 1	Thor Industries	Ohio	Travel trailers, motor homes	Bear, Stearns
6	24 0	Specialty Chemical Resources	Ohio	Mnfr industrial chemicals	Furman Selz Inc
7	26 3	Sun Television & Appliances	Ohio	Operate television stores	Montgomery Securities
8	26 3	Sun Television & Appliances	Ohio	Operate television stores	Montgomery Securities

1992 SECONDARY COMMON STOCK UNDERWRITINGS
(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
9	27	Mid-American Waste Systems	Ohio	Provide waste management svcs	Alex. Brown & Sons
10	30 2	Provident Bank	Ohio	Bank holding company	Lehman Brothers
11	33 8	Chemed	Ohio	Chemicals, janitorial equip	First Boston
12	34 0	Amcast Industrial	Ohio	Mnfr metal tubing, auto parts	Dillon, Read
13	368 0	Federated Department Stores	Ohio	Department and grocery stores	Lehman Brothers
14	48 8	Standard Products	Ohio	Mnfr rubber, plastic auto prod	Bear, Stearns
	1014.6				
1	4 2	Latex Resources	Oklahoma	Oil and gas expl,prodn	Chelsea Street Securities
2	40 3	Reading & Bates	Oklahoma	Oil and gas drilling and prodn	Smith Barney, Harris Upham
3	80	Devon Energy	Oklahoma	Oil and gas exploration, prodn	First Boston
4	97 0	Williams Cos	Oklahoma	Operate gas, petro pipelines	Lehman Brothers
	221.5				
1	131.3	Willamette Industries	Oregon	Timber tracts, mnfr wood prod	Goldman, Sachs
2	25 9	Northwest Natural Gas	Oregon	Gas utility	Merrill Lynch & Co.
3	6 0	Ag Bag International	Oregon	Manufacture feed bagging equip	Chatfield Dean
4	76 8	Fred Meyer	Oregon	Operate discount,grocery store	Goldman, Sachs
	240.0				
1	10 5	Pennsylvania Enterprises Inc	Pennsylvania	Gas and water utility hldg co	Wheat First Butcher & Singer
2	103 5	Comcast	Pennsylvania	Cable TV,cellular telecomm svc	Lehman Brothers
3	11 3	ACS Enterprises	Pennsylvania	Own and operate cable TV sys	Gerard, Klauer, Attison & Co.
4	125 5	Rohm and Haas	Pennsylvania	Mnfr industrial chemicals	Goldman, Sachs
5	13 1	Dauphin Deposit	Pennsylvania	Bank holding company	Bear, Stearns
6	14 7	First Western Bancorp	Pennsylvania	Bank holding company	Legg Mason Wood Walker
7	146 6	USX-US Steel Group	Pennsylvania	Manufacture steel products	Goldman, Sachs
8	156 0	Bethlehem Steel	Pennsylvania	Manufacture steel products	Salomon Brothers
9	156 6	Consolidated Natural Gas	Pennsylvania	Gas utility holding company	First Boston
10	18 0	Harley Industries	Pennsylvania	Mnfr microwave components	Ladenburg, Thalmann
11	19	Pennsylvania Enterprises Inc	Pennsylvania	Gas and water utility hldg co	Wheat First Butcher & Singer
12	22 5	Adelphia Communications	Pennsylvania	Operate cable TV systems	Salomon Brothers
13	24 9	Michael Baker	Pennsylvania	Provide engineering services	PaineWebber
14	30 9	Harleysville Group	Pennsylvania	Property, casualty insurance	Alex. Brown & Sons
15	32 5	Genesis Health Ventures	Pennsylvania	Operate geriatric facilities	Smith Barney, Harris Upham

1992 SECONDARY COMMON STOCK UNDERWRITINGS

(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
16	393 8	USX-Marathon Group	Pennsylvania	Oil and gas exploration, prodn	Lehman Brothers
17	4 0	Response USA	Pennsylvania	Mnfr,service security systems	Lew Lieberbaum & Co.
18	477 5	York International Corporation	Pennsylvania	Mnfr refrigeration equipment	First Boston
19	48 3	UGI	Pennsylvania	Gas and electric utility	Donaldson, Lufkin & Jenrette
20	50 0	Equimark	Pennsylvania	Bank holding company	Advest
21	54 0	Lukens Inc.	Pennsylvania	Mnfr steel plates	First Boston
22	6 0	DRS Industries	Pennsylvania	Prov finl and consulting svc	Chatfield Dean
23	69 0	Vishay Intertechnology	Pennsylvania	Mnfr resistors, measuring prod	Bear, Stearns
24	88 2	Jones Apparel Group	Pennsylvania	Mnfr,whl women's clothing	Merrill Lynch & Co
	2076.4				
1	236 8	GTECH Holdings	Rhode Island	Mnfr computer terminals	Donaldson, Lufkin & Jenrette
2	5 6	TSS	Rhode Island	Coupon distribution services	Paulson Investment
	242.4				
1	17 6	Gates/FA Distributing	South Carolina	Wholesale computer products	Robinson-Humphrey
2	49 5	Oneita Industries	South Carolina	Mnfr blank T-shirts	Oppenheimer
3	67 8	Liberty	South Carolina	Life ins;operate TV stations	Goldman, Sachs
4	80 3	SCANA	South Carolina	Electric and gas, utility	PaineWebber
	215.2				
1	112 8	AutoZone	Tennessee	Retail auto parts stores	Lehman Brothers
2	15 9	United Cities Gas	Tennessee	Gas utility	PaineWebber
3	27 6	Proffitt's	Tennessee	Own and operate dept stores	First Boston
4	31 6	Chattem	Tennessee	Mnfr medicines and chemicals	Wheat First Butcher & Singer
5	35 8	Catherines Stores	Tennessee	Women's clothing stores	Merrill Lynch & Co.
6	37 2	First American	Tennessee	Bank holding company	Merrill Lynch & Co.
7	44 5	Clayton Homes	Tennessee	Mnfr and retail mobile homes	Merrill Lynch & Co.
8	5 1	Aspen Marine Group	Tennessee	Houseboat rental services	Chatfield Dean
	310 5				
1	106 1	CompUSA	Texas	Own,operate computer stores	First Boston
2	116 9	Enron Oil & Gas	Texas	Oil and gas exploration, prodn	Goldman, Sachs
3	14 3	Chiles Offshore	Texas	Provide oil well drilling svcs	Salomon Brothers

1992 SECONDARY COMMON STOCK UNDERWRITINGS

(Source: Securities Data Company -- excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
4	14 7	First Amarillo Bancorporation	Texas	Bank holding company	Keefe, Bruyette & Woods
5	16 9	IMCO Recycling	Texas	Manufacture recycled aluminum	Smith Barney, Harris Upham
6	169 1	Baker Hughes	Texas	Oil field machinery, equipment	Goldman, Sachs
7	18 2	Benchmark Electronics	Texas	Mnfr printed circuit boards	Stephens
8	19 2	Plains Resources	Texas	Oil and gas exploration, prodn	Smith Barney, Harris Upham
9	19 9	Cliffs Drilling	Texas	Oil and gas expl,prodn	Howard, Weil, Labouisse
10	2 9	International Testing Services	Texas	Provide testing services	PaineWebber
11	20 0	American Exploration	Texas	Oil and gas exploration, prodn	Lehman Brothers
12	20 2	Digicon	Texas	Oil and gas services	PaineWebber
13	204 4	Enron	Texas	Gas pipelines; oil, gas expl	First Boston
14	23 2	Continuum Company	Texas	Develop software	Lehman Brothers
15	24 8	EZCORP	Texas	Provide financial services	Kidder, Peabody
16	243 6	Browning-Ferris Industries	Texas	Provide waste management svcs	First Boston
17	25 0	Tejas Gas	Texas	Operate gas pipeline	Lehman Brothers
18	25 3	Digicon	Texas	Oil and gas services	PaineWebber
19	25 4	Input-Output	Texas	Mnfr seismic measurement equip	Salomon Brothers
20	264 6	Oryx Energy	Texas	Oil and gas exploration, prodn	First Boston
21	28 5	Software Spectrum	Texas	Whl computers and peripherals	Dean Witter Reynolds
22	29 4	Westcott Communications	Texas	Provide educ broadcasting svcs	Alex. Brown & Sons
23	29 5	Production Operators	Texas	Provide oil an gas field svcs	Tucker Anthony
24	3 0	United Heritage	Texas	Manufacture medical equipment	Chelsea Street Securities
25	342 0	AMR	Texas	Passenger airline; holding co	Goldman, Sachs
26	36 0	Heritage Media	Texas	Operate radio and TV stations	Goldman, Sachs
27	38 0	Henley International	Texas	Mnfr surgical instruments	Kemper Securities
28	39 8	Amtech	Texas	Radio frequency equipment	Alex. Brown & Sons
29	40 0	TNP Enterprises	Texas	Electric utility; holding co	Dillon, Read
30	43 4	BJ Services	Texas	Provide pressure pumping svcs	First Boston
31	438 0	Union Texas Petroleum Holdings	Texas	Oil and gas exploration, prodn	Goldman, Sachs
32	44 5	Nabors Industries Inc	Texas	Oil and gas drilling services	Wertheim Schroder
33	45 0	Cash America Investments	Texas	Own,op pawn shops;whl handbags	The Principal/Eppler, Guerin
34	46 0	Parker & Parsley Petroleum	Texas	Oil and gas exploration, prodn	Dean Witter Reynolds
35	5 0	Hughes Resources	Texas	Gold mining	Chatfield Dean
36	51 9	Property Trust of America	Texas	Real estate investment trust	Merrill Lynch & Co.
37	55 3	Global Marine	Texas	Offshore drilling svcs,hldg co	Salomon Brothers
38	56 7	Pogo Producing	Texas	Oil and gas exploration, prodn	Goldman, Sachs

1992 SECONDARY COMMON STOCK UNDERWRITINGS
(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
39	57	Michaels Stores	Texas	Specialty retail stores	First Boston
40	58 4	American Oil and Gas	Texas	Oil and gas drilling services	Morgan Stanley
41	60 0	Valero Energy	Texas	Provide gas transmission svcs	Lehman Brothers
42	64 0	Capstead Mortgage	Texas	Real estate investment trust	PaineWebber
43	67 3	Weingarten Realty Investors	Texas	Real estate investment trust	Merrill Lynch & Co.
44	76 8	Paging Network	Texas	Provide paging services	Prudential Securities Inc.
45	78 3	Southwest Airlines	Texas	Passenger airline	Merrill Lynch & Co
46	8 2	First Cash	Texas	Used merchandise stores	William K. Woodruff
47	92 1	Transco Energy	Texas	Oil and gas transmission, prod	First Boston
48	96 0	Maxus Energy	Texas	Oil and gas exploration, prodn	First Boston
	3404.8				
1	0 6	Vystar Group	Utah	Mnfr video cameras,computers	First Capital Securities
2	17 5	TheraTech	Utah	Develop drug delivery systems	William Blair
3	5 1	Merit Medical Systems	Utah	Mnfr,whl medical products	Dain Bosworth
	23.2				
1	33.8	Ben & Jerry's Homemade	Vermont	Produce ice cream	Tucker Anthony
1	102 8	Central Fidelity Banks	Virginia	Bank holding company	Robinson Humphrey
2	114 7	Signet Banking	Virginia	Bank holding company	Goldman, Sachs
3	12 5	Allstate Financial	Virginia	Personal credit institutions	William Blair
4	12 8	F&M National	Virginia	Multi bank holding company	Robinson Humphrey
5	13 8	Excalibur Technologies	Virginia	Computer programming services	Allen & Co
6	14 0	Cel Sci Corp	Virginia	Mnfr diagnostic substances	Kober Financial
7	50	Chesapeake	Virginia	Mnfr paper and pulp products	Goldman, Sachs
8	70 2	Crestar Financial	Virginia	Bank holding company	Morgan Stanley
9	71 8	United Dominion Realty Trust	Virginia	Real estate investment trust	Merrill Lynch & Co.
10	9 7	Commerce Bank	Virginia	Commercial bank	Wheat First Butcher & Singer
	472.3				
1	12 0	Metropolitan Federal S&L Assn	Washington	Savings and loan	Montgomery Securities
2	13 7	Cascade Natural Gas	Washington	Distribute natural gas	Piper, Jaffray & Hopwood
3	21 6	ICOS	Washington	Manufacture medications	PaineWebber

1992 SECONDARY COMMON STOCK UNDERWRITINGS
(Source: Securities Data Company – excludes best-efforts underwritings)

	$ Millions	Company	State	Business	Underwriter
4	53 0	Puget Sound Power & Light	Washington	Electric utility	Merrill Lynch & Co
5	57 8	Washington Energy	Washington	Gas utility	Lehman Brothers
6	6 9	ProCyte	Washington	Commercial biological services	William Blair
	165 0				
1	12 5	Bando McGlocklin Capital	Wisconsin	Corporate financial svcs	Robert W Baird
2	12 6	Sullivan Dental Products	Wisconsin	Wholesale dental products	Robert W Baird
3	12 9	Northland Cranberries	Wisconsin	Produce cranberries	Kemper Securities
4	183 6	MGIC Investment	Wisconsin	Mortgage insurance agency	Goldman, Sachs
5	22 6	Wisconsin Public Service	Wisconsin	Electric and gas utility	Smith Barney, Harris Upham
6	25 4	Valley Bancorporation	Wisconsin	Bank holding company	Robert W Baird
7	69 0	Giddings & Lewis	Wisconsin	Design automated machine tools	First Boston
	338.6				
1	11.1	First Financial Caribbean	Puerto Rico	Consumer finance services	Brean Murray, Foster Secs
1	10 5	Palmer Tube Mills	Foreign	Mnfr, whl welded steel tubing	Kemper Securities
2	114 8	Singer NV	Foreign	Mnfr, whl sewing machines	Merrill Lynch & Co
3	2 1	BII Enterprises	Foreign	Mnfr comml lighting fixtures	The Ohio Company
4	243 8	Exel	Foreign	Casualty insurance company	Goldman, Sachs
5	25 4	Nova Corp of Alberta	Foreign	Oil and gas exploration, prodn	Merrill Lynch & Co.
6	313 5	News Corp	Foreign	Publish newspapers, magazines	Merrill Lynch & Co.
7	329 0	Total Cie Francaise	Foreign	Oil and gas exploration, prodn	Lehman Brothers
8	4 0	International Colin Energy	Foreign	Oil and gas exploration, prodn	Tamaron Investments, Inc
9	5 8	PI C Systems	Foreign	Manufacture medical lasers	H J Meyers
10	52 0	Rogers Cantel Mobile Commun	Foreign	Cellular telecommunication svc	Goldman, Sachs
11	7 9	Westpac Banking	Foreign	Bank holding company	First Boston
12	757 7	Telefonos de Mexico	Foreign	Telecommunications services	Goldman, Sachs
13	87 0	Mutual Risk Management	Foreign	Mutual risk management svcs	Morgan Stanley
14	89 7	Newbridge Networks	Foreign	Mnfr area networking products	Alex Brown & Sons
	2043.2				

Note. Includes firm commitment underwritings of common stock of companies whose stock is already publicly traded, excludes mutual funds

Attachment II

Discussion of Amendments to the Investment Company Act of 1940 (the "1940 Act").

The Small Business Incentive Act of 1993 would make certain amendments to the provisions in the 1940 Act with the intention of channeling more funds to small businesses. These changes are outlined below.

(i) *Business Development Companies ("BDCs")*—In 1980, Congress added Sections 54–65 of the 1940 Act permitting the creation of BDCs. Congress intended that these provisions "establish a separate and distinct regulatory scheme for [BDCs] which otherwise might be regulated as investment companies. . . ."[1] Although BDCs are intended to facilitate pooled investments in small businesses, they have not been a major funding vehicle for small businesses. The legislation is intended to make BDCs more flexible. Major changes would include:

(a) *Acquisition of Securities*—Section 208 of the bill would amend Section 55 of the 1940 Act to permit a business development company to acquire the securities of an eligible portfolio company from persons other than the eligible portfolio company (and its affiliated persons), subject to the Commission's rules. Section 55(a)(1)(A) currently requires a BDC to acquire the securities of an eligible portfolio company directly from an eligible portfolio company, or from certain other persons.

(b) *Expanded Eligible Portfolio Company Definition*—Section 206 of the bill would expand the scope of companies that the 1940 Act defines as an "eligible portfolio company." As a consequence of the change, BDCs would have greater flexibility to invest in more types of companies.

(c) *Broadening the 70 Percent Test*—Section 208 of the bill would amend the 1940 Act to provide that securities of companies that fall within the new definition of eligible portfolio company in Section 2(a)(46)(C)(iii) qualify as being within the "70 percent" test of Section 55(a). Currently, the 1940 Act requires that BDCs invest at least 70 percent of their assets (with certain exceptions) in small or troubled companies.[2]

(d) *Managerial Assistance Requirement Relaxed*—Section 207 of the bill would amend the 1940 Act to provide that a BDC need not make available significant managerial assistance to any company that falls within the new definition of "eligible portfolio company" in Section 2(a)(46)(C)(iii). Section 2(a)(48) currently requires a BDC to make available significant managerial assistance to all the companies treated by it as satisfying the 70 percent test of Section 55(a) of the 1940 Act. This change is intended to encourage the flow of capital to very small businesses.

(e) *Liberalize Leverage Restrictions*—Section 209 of the bill would ease leverage restrictions on BDCs. Currently, Section 18(a)(1)(A) of the 1940 Act, as further modified by Section 61(a)(1) of the 1940 Act, imposes an asset coverage requirement of 200 percent for both senior equity securities and senior debt. Section 209 of the bill would permit a BDC to have asset coverage of 110 percent if it meets certain conditions.

(f) *Liberalize Restrictions on Debt Securities Issuance*—Section 209 would permit a BDC to issue multiple classes of debt securities without restriction. Currently, Section 61(a)(2) provides that a BDC may issue more than one class of senior security representing indebtedness if the BDC does not have outstanding any publicly held debt and all such securities are privately held or guaranteed by the Small Business Administration, or banks, insurance companies, or other institutional investors, and are not intended to be publicly distributed. The bill would delete all of these conditions on issuing multiple classes of debt securities.

(g) *Liberalize Restrictions on Rights Issuance*—Section 209 of the bill would liberalize the 1940 Act's restrictions on BDCs issuing warrants, options, or rights. Currently, the 1940 Act allows BDCs to issue warrants, options, and rights in certain circumstances. The bill would give BDCs greater flexibility to issue warrants, options, or rights, either alone, or accompanied by other securities.

(h) *Broaden Disclosure Obligations*—Section 210 of the bill would amend Section 64(b)(1) to expand disclosure requirements for shareholders and the Commission with respect to a BDC's capital structure.

(ii) *Private Investment Companies*—The bill would create a new exception from the 1940 Act for sophisticated investors. Section 3(a) of the 1940 Act defines an "investment company" for purposes of that act, but Section 3(c) provides certain excep-

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[1] H.Rep. 1341, 96th Cong. 2d. Sess. 37, as reprinted in 1980 U.S.C.C.A.N. 4819 ("Small Business Report").

[2] *See* Small Business Report, at 4820.

tions from the definition. Section 201 of the bill would add a new Section 3(c)(7) of the 1940 Act, creating an exception from the definition of investment company for investment pools whose securities are held exclusively by "qualified purchasers," as defined below. The bill also would add Section 2(a)(51) of the 1940 Act, defining a qualified purchaser a persons who has financial sophistication, minimum net worth, and other criteria. The bill does not except private investment companies from the requirements of Section 12(d)(1) (A)(i) and (B)(i) of the 1940 Act "governing the purchase or other acquisition by such issuer of any security issued by a registered investment company and the sale of any security issued by a registered open-end investment company to any such issuer."[3] Registered investment companies selling their securities to Section 3(c)(7) issuers also would be subject to Section 12(d)(1)(B)(i).

(iii) *Simplify Attribution Rules Regarding 100 Investor Exception*—Section 201 of the bill would simplify the rules for determining when an investment company has exceeded the limitation for 100 investors.

Currently, Section 3(c)(1) of the 1940 Act creates an exclusion for any issuer whose outstanding securities (other than short term paper) are beneficially owned by not more than one hundred persons and which is not making and does not presently propose to make a public offering of its securities.

Section 3(c)(1)(A) of the 1940 Act further provides that "beneficial ownership by a company shall be deemed to be beneficial ownership by one person, except that if the company owns 10 percent or more of the outstanding voting securities of the issuer, the beneficial ownership shall be deemed to be that of the holders of such company's outstanding securities (other than short term paper)."

Section 3(c)(1)(A) includes a Paragraph that further provides that the shares of the company shall not be attributed to the company's beneficial owners if, as of the date of the company's most recent acquisition of the issuer's securities, the value of all securities owned by the company of all issuers that are, or would be, but for this exception, excluded from the definition of this paragraph, does not exceed 10 percent of the value of the company's total assets. Current law specifies that the issuer is still deemed to be an investment company for purposes of Section 12(d)(1). The effect of this Paragraph is to provide an "escape" from having the shares of the company attributed to the shareholders.

The bill would modify this subsection of the 1940 Act in the following ways:

(i) it would amend Subsection 3(c)(1)(A) by inserting in subparagraph (A) of subsection (c) after the first occurrence of the word "issuer," the following: "and the company is or, but for the exceptions set forth in this paragraph and paragraph (7), would be an investment company,"; and

(ii) it would delete the Paragraph creating an exception for certain companies.

The purpose of these changes are to make it more difficult to attribute the shareholders of the company purchasing shares in the issuer to the 100 shareholder ceiling. Only for companies that: (i) own 10 percent or more of the issuer; and (ii) are, or but for the exception in Sections 3(c)(1) or (7) would be, investment companies, would the provision require attribution of shareholders towards the 100 person total. (Section 3(c)(7) refers to the private investment company owned by qualified purchasers.) Because the bill would make attribution much more difficult, the drafters believe that there is no need for the escape provision of the Paragraph.

The bill also would amend Section 3(c)(1) to provide that

> [a Section 3(c)(1)] issuer nonetheless is deemed to be an investment company for purposes of the limitations set forth in section 12(d)(1) (A)(i) and (B)(i) governing the purchase or other acquisition by such issuer of any security issued by a registered investment company and the sale of any security issued by a registered open-end investment company to any such issuer.

As noted with respect to Section 3(c)(7) issuers, the bill would impose the limitations of Section 12(d)(1)(A)(i) in connection with the purchase of securities issued by registered investment companies.

In addition, Section 203 of the bill would amend Section 3(a)(3) of the 1940 Act by adding a new subparagraph providing that "securities issued by any majority-owned subsidiary of the owner, unless such subsidiary is an investment company

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[3] Section 201 of the bill would provide (4) by restating subsection (7) to read as follows:

(7) Any issuer whose outstanding securities are owned exclusively by persons who, at the time of acquisition of such securities, are qualified purchasers, except that such issuer shall be deemed to be an investment company for purposes of the limitations set forth in section 12(d)(1)(A)(i) and (B)(i) governing the purchase or other acquisition by such issuer of any security issued by a registered investment company and the sale of any security issued by a registered open-end investment company to any such issuer.

Section 12(d)(1) of the 1940 Act restricts pyramiding or "funds of funds."

or is excluded from the definition of an investment company solely by virtue of paragraph (1) or (7) of section 3(c)." The amendment would prevent a company from avoiding regulation under Section 3(a)(3) of the 1940 Act by establishing a Section 3(c) (1) or (7) subsidiary.

(iv) *Business and Industrial Development Companies ("BIDCOs")*—Section 204 of the bill would add new exemptions for BIDCOs under the 1940 Act. The bill would add a new Section 6(a)(5) to the 1940 Act providing as follows:

(5)(A) Any company that is not engaged in the business of issuing redeemable securities, and the operations of which are subject to regulation by the State in which it is organized under a statute governing entities that provide financial or managerial assistance to enterprises doing business or proposing to do business, primarily in that State if—

(i) the organizational documents of the company state that the purpose of the company is limited to providing financial or managerial assistance to enterprises doing business, or proposing to do business, primarily in that state;

(ii) immediately following each sale of the securities of such company by the company or any underwriter for the company, not less than 80 percent of the company's securities being offered in such sale, on a class-by-class basis, are held by persons who reside or have a substantial business presence in that State;

(iii) the securities of such company are sold, or proposed to be sold, by the company or any underwriter for the company, solely to accredited investors, as defined in Section 2(15) of the Securities Act of 1933, or to such other persons that the Commission, as necessary or appropriate in the public interest and consistent with the protection of investors, may permit by rule, regulation, or order; and

(iv) the company does not purchase any security issued by an investment company, as defined in Section 3 of [the 1940 Act], or by any company that would be an investment company except for the exclusions from the definition of investment company in Section 3(c), other than—

(I) any security that is rated investment grade by at least 1 nationally recognized statistical rating organization; or

(II) any security issued by a registered open-end investment company that is required by its investment policies to invest at least 65 percent of its total assets in securities described in subclause (I) or securities that are determined by such registered open-end investment company to be comparable in quality to securities described in subclause (I).

(B) Notwithstanding the exemption provided in this paragraph, the provisions of section 9[4] (and, to the extent necessary to enforce such provisions, Sections 38 through 51) of [the 1940 Act] shall apply to a company described in this paragraph as if the company were an investment company registered under this title.

(C) Any company proposing to rely on the exemption provided in this paragraph shall file with the Commission a notification stating that it intends to do so, in such form and manner as the Commission may by rule prescribe.

(D) Any company meeting the requirements of this paragraph may rely on this exemption immediately upon filing with the Commission the notification required by subparagraph (C), unless the Commission determines by order that such company's reliance is not in the public interest or consistent with the protection of investors.

(E) The exemption provided pursuant to this paragraph may be subject to such additional terms and conditions as the Commission may by rule, regulation, or order determine are necessary or appropriate in the public interest or for the protection of investors.

(v) *Increase Closed-End Investment Company Exemption*—Section 205 of the bill would increase the intrastate exemption for closed end investment companies. Currently, Section 6(d)(1) of the 1940 Act provides an exemption for closed-end companies: (1) if the aggregate sums receive by the company, plus the aggregate offering price of all securities of which the company is the issuer and which it proposes to offer for sale, do not exceed $100,000; (2) the securities are offered to residents of the state under the laws of which the company is organized; and (3) the exemption is in the public interest. The bill would increase the dollar amount from $100,000

[4] Section 9(a) of the 1940 Act makes it unlawful for persons who have committed certain offenses to serve as an officer, director, or similar position of a registered investment company. Section 9(b) permits the Commission to restrict persons from serving in such capacities. Section 9(c) provides procedural protections to persons limited by Section 9(a). Section 9(d)–(f) include remedies available to the Commission.

to $10,000,000 or such other amount as the Commission may set by rule, regulation, or order.

STATEMENT OF PATRICIA A. JEHLE

SENIOR MANAGING DIRECTOR, BEAR, STEARNS AND CO., INC.

ON BEHALF OF THE PUBLIC SECURITIES ASSOCIATION

MARCH 4, 1993

Chairman Dodd and Members of the Subcommittee, good morning. My name is Patricia Jehle. I am pleased to be here today to discuss an issue of critical importance to the continued economic recovery of the nation—the availability of credit to small businesses.

I speak to you this morning not only in my capacity as a senior managing director at the securities firm of Bear, Stearns and Co., Inc. in New York, but also on behalf of the Public Securities Association (PSA), of which my firm is a member. PSA is the international trade organization of securities firms and banks that underwrite and trade mortgage- and asset-backed securities, U.S. Government and agency securities, municipal securities and money-market instruments. PSA's membership includes all major dealers in mortgage- and asset-backed securities. On behalf of PSA, I would like to commend you, Mr. Chairman, for holding this hearing and thank you for the opportunity to participate.

I understand that this Subcommittee will hear testimony today from a variety of witnesses with expertise in many aspects of small business finance and development. My professional background, as well as the interest of PSA, is in the area of asset securitization. I will therefore confine my comments to the availability of small business credit generally and to issues surrounding the securitization of small business loans.

Credit Issues Associated With Securitizing Commercial Loans

The problem of credit availability for small businesses has received much attention in recent months. Policy-makers here in Washington and capital market participants around the country have proposed a number of statutory changes designed to increase bank lending to small enterprises. Because developments in the secondary market for home mortgages have successfully expanded sources of capital for homebuyers, and because the capital markets have demonstrated ingenuity in securitizing many other types of financial assets, many of today's small-business proposals involve provisions to encourage the securitization of small-business loans. Presumably, this would attract new sources of capital to the small-business lending market and would result in a greater volume of small-business loans at lower interest rates.

One of the problems immediately apparent in attempting to create a market for securitized small-business loans akin to the mortgage-backed securities market relates to the nature of small-business lending and the kind of relationship that exists between banks and their commercial clients. Unlike homebuyers, small businesses shopping for credit often have ongoing financing needs that cannot be satisfied with a single loan or a single type of loan. It could work against the interests of both a bank and its borrower-client, for example, for the bank to originate a simple term loan and immediately sell it into the secondary market, as is done with residential mortgages. It is often the case that long before the loan is paid, the borrowing needs of the business change, and the loan must be restructured. The need for this type of flexibility would not necessarily prevent securitization of small business loans. Rather, given the right incentives, the market is sufficiently flexible to put in place mechanisms that would take into account the special relationship between the small business and its bank.

A more liquid secondary market for small commercial loans could enhance the availability of credit to small businesses. Taking expanded small commercial credit securitization as a desirable development, the basic policy question is why does it not occur on a wider scale. If the answer is that the transaction is not economically viable, then a logical policy response would be to subsidize the activity in some way, assuming the benefits of the securitization outweighed the costs of the subsidy. If the answer is that the legal or regulatory structure impedes efforts to securitize commercial credit, then a simpler response might be to loosen existing restrictions

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Sources: Draft Bill, Section-by-Section Description of Bill.

so as to allow otherwise viable transactions to proceed. As it happens, both of these answers are relevant.

The primary hurdle to overcome in the securitization of commercial loans involves credit risk. Several methods have developed in the asset-backed securities market to raise the credit rating of a transaction to "AA" or better. Credit enhancement could involve over-collateralization, the retention of a subordinated piece by the issuer of the asset-backed security, or some form of outside credit enhancement such as letters of credit or insurance policies.

Most small-business loans do not enjoy any sort of Federal guarantee, nor are the revenues from the loans high enough to supply credit support through spread accounts as in the credit card-backed securities market. Moreover, the collateral associated with small-business loans is more difficult for lenders to work with in the event of foreclosure. The plant and inventory of a failed business is less valuable to a bank than a piece of foreclosed residential real estate. In addition, the securitization of small-business loans does not offer the actuarial credit advantages of a credit card security. Credit card securities typically involve large numbers of credit card holders, so that the diversification improves the overall creditworthiness of the pool of assets. An issuer of a small-business credit-backed security would typically not have access to such a large number of similar commercial loans, or may have concentrations within industries or geographic areas which would indicate higher levels of credit risk.

Credit enhancement is therefore an essential element to securitizing small business loans. Regardless of its form, credit enhancement essentially shifts credit risk from the investors to the provider of the credit enhancement. To the extent that banks are potential providers of credit enhancement, current bank regulatory policy would seem to discourage such activities by banks. This problem suggests two possible policy responses. One would be to try to adjust bank regulatory policy to facilitate small business loan securitization. The second would be to address the credit problem through some sort of Federal credit enhancement, either directly or implicitly. Each of these responses has advantages and disadvantages.

Regulatory Policy and Small-Business Credit Securitization

A major objective for banks in a securitization is to remove assets from the balance sheet, increasing the ratio of capital to assets. Whether this is possible depends on whether federal regulators consider the transfer of loans to an asset pool a sale of assets or a collateralized borrowing. If the transaction is treated as a sale, then the assets are removed from the balance sheet. If the transaction is treated as a collateralized borrowing, then the assets remain on the balance sheet and are subject to capital requirements; likewise, the related liabilities are subject to reserve requirements.

Under the Call Report instructions for commercial banks, transfers of assets are treated as sales only if the transfer involves no risk of loss, except for transactions involving participations in pools of residential mortgages. Since small-business loan securitization would often require the issuing bank to retain some risk, banks would not be able to remove the loans from their balance sheets, and would lose a major advantage of the transaction. In fact, even if a bank retains only a small subordinated portion of a commercial loan, it must retain capital against the entire loan.

Federal regulators are rightly concerned that banks be required to hold capital against risk. In requiring that the amount of capital required to be maintained by an insured depository institution with respect to the sale of small business loans with recourse should not exceed an amount sufficient to meet the institution's reasonable estimated liability under the recourse arrangement, S. 384, the "Small Business Loan Securitization and Secondary Market Enhancement Act of 1993," takes the correct conceptual approach to addressing regulatory concerns and removing impediments related to the securitization of small-business loans.

Federal Credit Enhancement

Another method to overcome the credit problems associated with small business loan securitizations would be to provide some sort of federal credit enhancement. The mortgage-backed securities market has enjoyed extraordinary growth largely as the result of the federal credit support for Ginnie Mae and the federal sponsorship of Fannie Mae and Freddie Mac. A federally-sponsored agency could be created to encourage a secondary market in small commercial loans.

Such an agency could certainly stimulate securitization if any federal credit support were perceived by the market. In addition, standardization could be increased in the market by the work of such an agency if it achieved any significant size. One of the major accomplishments of the federal housing agencies has been to standardize the documentation in the housing market. They were able to do this because the

federal sponsorship allowed these agencies to achieve a large enough size to set standards for the market.

However, a federally-sponsored agency providing credit support to encourage small-business credit securitization would expose the federal government to the same risk of loss as a bank would retain under a sale with recourse. Without such federal credit support, it is not clear what advantage a GSE would offer over private initiatives.

Tax Complications Associated With Small-Business Credit Securitization

Transactions in securities backed by small-business loans also face tax problems. The 1986 Tax Act dealt with similar tax problems associated with the issuance of mortgage-backed securities through the creation of Real Estate Mortgage Investment Conduits (REMICs).

One of the most economically efficient ways to securitize real estate mortgage loans is by issuing multi-class mortgage-backed securities (MBS). Under pre-1986 federal tax law, multi-class MBS could not be structured as equity interests in mortgage pools. Rather, interests in multi-class MBS—also known as collateralized mortgage obligations (CMOs)—had to be issued as debt instruments. Moreover, under previous law, it was possible for the cash flow from mortgage pools to be subject to double taxation, once at the level of the securities issuer and once at the level of the investor. This was especially true for holders of residual classes, who received excess cash flow from the mortgage pool after the other classes of investors had been paid.

The Tax Reform Act of 1986 addressed problems associated with the tax treatment of multi-class MBSs by defining a new means of issuing these securities. In a typical REMIC transaction, a pool of loans is transferred from the REMIC sponsor to a qualified REMIC trust in exchange for the securities issued by the trust and backed by the pool, both regular and residual classes. The securities are then sold to investors. Under the REMIC provisions of the 1986 Act, multi-class MBSs can be issued as either secured debt instruments or equity participations in the asset pool. The REMIC itself can be a trust, a corporation, a partnership, or even a segregated pool of assets with no status as a legal entity. Also, qualified REMICs are essentially tax-exempt entities, so income generated by the asset pool is not taxable at the REMIC level, thus solving the problem of double taxation.

REMIC rules apply only to pools of real estate mortgage loans, not to pools of other assets such as commercial loans (except for commercial real estate mortgages). A new tax structure could be developed for asset-backed securitization which would extend REMIC treatment to assets other than real estate mortgages. One provision of S. 384 would authorize the Treasury Department to extend REMIC treatment to securitized pools of small business loans. PSA supports efforts to extend REMIC-like treatment to small business loan securitization. While the REMIC concept should be applied to small business loan securitization specifically and the asset-backed market more broadly, not all of the REMIC provisions are applicable to the asset-backed securities market as a whole. Consequently, PSA encourages Congress to move forward on a draft legislative proposal, known as the Financial Asset Securitization Investment Conduit (FASIT). FASIT would create a new, special purpose tax vehicle for asset securitization, which, among other things, would facilitate the issuance of multi-class securities for revolving assets—a structure that could prove useful to the securitization of small-business loans.

Standardization

Lack of standardization is an impediment to the growth of the secondary market for small-business loans. If existing impediments to small-business credit securitization were removed and the volume of these activities increased, standards might be expected to converge as the market sorted out which kinds of loans were most suitable for securitization. The Federal government could establish standards itself by becoming a participant in the secondary market, as it has done in the mortgage market. In the mortgage market, the standards established by the federal housing agencies became market standards because of the large size these institutions attained as a result of federal sponsorship.

Comments on S. 384

PSA supports S. 384 because it represents a sound approach to addressing the illiquidity of the small-business loan market. The bill correctly identifies and specifically addresses the vast majority of legal and regulatory impediments that currently exist for a purchaser of small-business related securities.

I have already stated that PSA supports a legislative proposal similar to Section 10 of the bill related to REMIC treatment for asset-backed securities. Section 8 of the bill, related to capital standards for banks that invest in securitized small-busi-

ness loans or that sell loans with recourse, conceptually addresses some of the problems associated with credit support structures for small-business related securities.

The bill's change in regulatory capital requirements for small business loans sold with recourse may be the critical ingredient to incent banks to sell or securitize small-business loans. Further, if a bank retained recourse for the first losses through the retention of a subordinated piece, it would be relatively easy to obtain credit enhancement from financial guarantors or others in order to obtain a "AA" or "AAA" rating. I commend Senator D'Amato, Chairman Dodd and other co-sponsors of the bill for your efforts. S. 384, if adopted, would help create a more liquid market for small-business related securities.

Again, thank you for the opportunity to testify. I would be happy to entertain any questions.

TESTIMONY OF MARIANNE K. SMYTHE

DIRECTOR, DIVISION OF INVESTMENT MANAGEMENT
U.S. SECURITIES & EXCHANGE COMMISSION

THE SMALL BUSINESS INCENTIVE ACT OF 1993

Chairman Dodd, Senator Gramm, Members of the Subcommittee: I appreciate the opportunity to testify today on behalf of the Securities and Exchange Commission ("Commission") regarding the Small Business Incentive Act of 1993. The Commission enthusiastically supports this important legislation which is based largely on legislation called for by Chairman Breeden and the Commission and forwarded to Congress in April 1992. This legislation is intended to make it easier for small business to raise capital, while maintaining important investor protections.

While the Commission has not had sufficient time to develop an official position on the Small Business Loan Securitization and Secondary Market Enhancement Act of 1993, S. 384,[1] Chairman Breeden and members of the Commission have frequently called for expansion of securitization of non-mortgage financial assets, and specifically for the development of a secondary market for securities backed by a pool of small business loans. Indeed, in February 1992, the Chairman said, in a speech before the National Press Club, "[B]y seeking to adapt the techniques of securitization to small business loans—especially short term debt instruments, we have an opportunity to facilitate a market that will improve the availability, and hopefully reduce the costs, of capital for small firms." As an integral part of the Commission's "small business initiative," the Commission has taken several significant steps to enhance the utility of structured finance vehicles for small business capital formation. The measures proposed in the Small Business Loan Securitization and Secondary Market Enhancement Act of 1993 should facilitate further the use of structured finance as a source of capital for small business. The Commission strongly believes that wider use of prudent techniques of securitization is probably the best—and quite possibly the only—technique for really ending the "credit crunch" that has afflicted small business across the country.

Introduction

The past year has witnessed a great deal of discussion about the flow of capital to small business.[2] This discussion has been prompted by a growing concern that small business, which provides the major source of jobs for the American worker,[3] has been unable to raise or borrow capital with which to fuel growth, innovation, and expansion. "Capital is of course critical to any business, particularly small business. In recent times, however, financing for small business from traditional sources available to a company that is smaller than the size typically able to conduct an initial public offering has become more difficult to obtain."[4]

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[1] Small Business Loan Securitization and Secondary Market Enhancement Act of 1993, S. 384, 103d Cong., 1st Sess. (1993).

[2] *See, e.g.*, Udayan Gupta, *Venture Capitalists Raised 75 Percent More Money Last Year*, WALL ST. J., Jan. 29, 1993, at B2, col. 3; Udayan Gupta, *Venture Funds Regain Appetite For Start-Ups*, WALL ST. J., Sept. 21, 1992, at B1, col. 6; Brent Bowers, *Effort Grows to Help Tiny Firms Get Equity Financing*, WALL ST. J., Mar. 16, 1992, at B2, col. 3.

[3] *See* Figure A.

[4] Statement of Commission Chairman Richard C. Breeden, Hearing Before the Subcomm. on Securities of the Comm. on Banking, Housing, and Urban Affairs, 102d Cong., 2d Sess. (Mar. 26, 1992) at 7.

Venture capital firms, which can be either privately or publicly owned companies,[5] are an important source of that capital.[6] From 1982 to 1991, these firms invested over $27 billion in small businesses.[7] New investments by venture capital firms reached a peak of $4.0 billion in 1987.[8] Unfortunately, new investments declined to $1.4 billion in 1991, a ten year low.[9] Preliminary data suggest that these investments may have increased to $2.7 billion in 1992.[10] While a considerable improvement, these investments are substantially below the average of $3.6 billion that prevailed during the second half of the 1980's,[11] and the Commission applauds Congress' determination to press for further action in this area. We recognize and appreciate that the purpose of these bills is to amend the securities laws to enhance investment in small businesses without sacrificing investor protection.

Recent Commission Initiatives in the Area of Small Business

The Commission has taken several steps this past year to facilitate the flow of capital to small business. Regulations under both the Securities Act of 1933 ("Securities Act")[12] and the Securities Exchange Act of 1934 ("Exchange Act")[13] were amended to remove unnecessary barriers to the registration and sale of securities.

Regulation A under the Securities Act exempts small public offerings from the registration provisions of that Act.[14] Last year, the Commission amended Regulation A to raise the size limit for an offering using this simplified process from $1.5 million to $5 million.[15] Since this change was finalized on July 30, 1992, the volume of Regulation A offerings nearly quadrupled to $89 million, compared with $22.6 million before the Commission's action.[16]

In addition to expanding Regulation A, the Commission dramatically simplified the registration statement previously used for small business offerings, and removed an arbitrary size limit of $7.5 million per offering (or for repeated offerings during the succeeding twelve months following an initial public offering). Since the new "SB–2" form replaced the old 5–18 and offering limits were removed in August 1992, 74 offerings covering a total of $641.2 million have been registered with the Commission by small businesses. At the same time, the Commission took action to allow an issuer to use a "test the waters" document to assess interest in its securities before complying with the mandated disclosure requirements.[17] The Commission also amended Rule 504 of Regulation D to allow companies not yet registered under the Exchange Act to offer up to $1 million of unrestricted securities each year through a general solicitation without federal registration or a federal requirement that the offering be registered in the relevant states. Previously, Rule 504 did not permit the general solicitation of investors. Further, unless the securities were registered with the relevant states, they were not freely transferable by the investor, and the issuer was limited to offering $500,000 of unrestricted securities each year. Since the time

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[5] The Commission has no data solely on private venture capital firms, but does have data on two types of public venture capital firms: small business investment companies and business development companies. In 1992, there was a slight increase in the number of small business investment companies: from 10 such companies with $290.5 million in assets in 1991 to 11 such companies with $331.8 million in assets. While there were 49 business development companies in 1992 (one more than in 1991), their assets declined to $2.4 billion from $2.5 billion in 1991. *See* Figure B.

[6] We should not overlook that conventional investment companies also are an important source of capital for small businesses. In 1992, there were approximately 148 funds with more than $22.1 billion in net assets that invested primarily in companies with small market capitalizations. In 1991, there were 107 such funds with $16.1 billion in net assets. *See* Figure C.

[7] Calculation based on figures in *Disbursements Hit 10-Year Low,* VENTURE CAPITAL J., June 1992, at 27. While there is no uniform definition of "small business," one of the Small Business Administration's definitions includes any company which, together with its affiliates, does "not have net worth in excess of $6 million, and does not have average net income after federal income taxes (excluding any carry-over losses) for the preceding 2 years in excess of $2 million." 13 C.F.R. § 121.802(a)(2), amended in 57 FR 62477 (1992).

[8] *See Disbursements Hit 10-Year Low,* VENTURE CAPITAL J., June 1992, at 27. *See also* Figure D.

[9] *Id.*

[10] Figures reflect the first six months of 1992. Analysts with Venture Economics Publishing Co. supplied these figures to the Commission staff.

[11] Calculation based on data in *Disbursements Hit 10-year Low,* VENURE CAPITAL J., June 1992, at 27.

[12] 15 U.S.C. § 77a.

[13] 15 U.S.C. § 78a.

[14] 17 C.F.R. §§ 230.251–263.

[15] Small Business Initiatives, Securities Act Release No. 33–6949 (July 30, 1992), 57 FR 36442, 36468 (Aug. 13, 1992).

[16] Comparing filings made under Regulation A during the periods of August 13, 1992 through February 19, 1993, and August 13, 1991 through February 19, 1992, respectively.

[17] *Id.* at 36476, 36496, 36470.

of our amendments to Rule 504 in August 1992 through the end of calendar year 1992, more than 578 offerings involving $183.1 million have been made, most of which came from small business.[18]

Small Business Registration. The Commission also adopted an integrated registration and reporting system under the Securities Act and the Exchange Act for use by "small business issuers."[19] For purposes of this system, small business issuers generally include those issuers with annual revenues of less than $25 million and whose public float (the market value of voting securities held by non-affiliates) does not exceed $25 million.[20] This integrated system includes a new simplified form for small business issuers to register their securities under the Securities Act (Form SB–2) and allows them to satisfy their periodic reporting requirements under the Exchange Act on new simplified forms designed expressly for small businesses (Forms 10–KSB and 10–QSB).[21]

Structured Finance. The Commission also acted this past year to exempt structured finance vehicles (sometimes also called asset-backed arrangements) from the Investment Company Act of 1940 ("Investment Company Act"),[22] thus freeing these innovative products to be a source of capital to small business. Structured finance issuers pool income-producing assets, and issue securities backed by those assets.

The structured finance market has increased dramatically over the last decade. In 1981, there were just 17 structured finance issuances totalling $1 billion.[23] As of December 31, 1992, securities of structured financings publicly offered in the United States totalled approximately $428.6 billion, accounting, for approximately 50 percent of total public securities offerings (debt and equity) and 57 percent of total debt securities offerings.[24] Most of this activity, in volume terms, relates to offerings of securities by the government sponsored enterprises like Fannie Mae and Freddie Mac.

Despite this enormous growth, the Investment Company Act constrained the development of the structured finance market. Structured finance vehicles technically meet the definition of investment company (and would, unless exempted, be subject to Investment Company Act regulation) because they issue securities and are primarily engaged in investing in, owning, or holding securities.[25] Structured financings, however, are unable to operate under many of the Investment Company Act's requirements.

In a typical structured finance arrangement, the owner of financial assets, such as a bank, sells the assets to a special purpose entity, such as a trust, that ultimately issues one or more classes of securities backed by the assets. Because the owner and the issuer often are affiliated, the Investment Company Act would prohibit the owner's sale of assets to the issuer.[26] The Investment Company Act also frequently would preclude joint accounts where the initial owner and issuer share an interest in the excess cash flows from securitized assets.[27] These joint accounts, known as spread accounts, often are used as credit support for the financing. Finally, the Investment Company Act's limitations on senior securities and leverage would preclude the issuance of multiple classes of securities, as is common in most financings.[28]

To escape the Investment Company Act, structured financings either must fit within one of the Act's exceptions to the definition of investment company or seek exemptive relief from the Commission. Many financings rely on the exception in section 3(c)(5), which generally is available for issuers engaged in the business of acquiring notes or loans covering specified merchandise and services or interests in

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[18] During calendar year 1991, there were 1,259 Rule 504 offerings covering $377 million worth of securities. For calendar year 1992, there were 1,470 Rule 504 offerings for $434.7 million.

[19] *Id.* at 36450.

[20] *Id.* at 36472.

[21] *Id.* at 36473, 36498.

[22] 15 U.S.C. § 80a–1.

[23] David Kogut, *Corporate Finance 1985: The Red Hot Year,* INV. DEALERS' DIG., Jan. 13, 1986, at 23.

[24] Calculations based on data in *How Sweet It Was!* INV. DEALERS' DIG., Jan. 11, 1993, at 14, 16–18. *See also* Figure E containing comparative data reflecting the growth of the structured finance market between 1986 and 1992.

[25] *See* Investment Company Act § 3(a), 15 U.S.C. § 80a–3(a) (definition of investment company).

[26] *See* Investment Company Act § 17(a)(1), 15 U.S.C. § 80a–17(a)(1) (prohibiting an affiliated person of a registered investment company from selling securities to such company).

[27] *See* Investment Company Act § 17(d) and rule 17d–1, 15 U.S.C. § 80a–17(d), 17 C.F.R. § 270.17d–1 (governing joint transactions involving an affiliated person of a registered investment company and the registered investment company).

[28] *See* Investment Company Act § 18, 15 U.S.C. § 80a–18 (governing the capital structure of registered investment companies).

real estate.[29] The section 3(c)(5) exception is limited to financings involving certain types of assets, and most importantly for small business capital formation, would not permit securitization of all loans made to small business.[30]

To remove unnecessary barriers, the Commission adopted a rule conditionally exempting structured financings from regulation under the Investment Company Act.[31] The conditions of the rule seek to delineate the operational distinctions between registered investment companies and structured finance vehicles, permit the continued evolution of the structured finance market, and address investor protection concerns.[32]

Shelf Registration. The Commission also expanded the availability of Rule 415, the "shelf registration rule," to a greater number of structured finance transactions.[33] The "shelf registration" procedure provides issuers eligible to use Form S–3 with the flexibility to access the public securities markets on demand, without having to obtain additional clearance from the Commission staff. The Commission revised Form S–3 specifically to permit companies to register investment grade asset-backed securities without regard to their reporting history.[34] Before the revision, the benefits of Form S–3 and shelf registration for delayed offerings generally were not available to issuers of non-mortgage related investment grade asset-backed securities. As a result, for example, investment grade securities backed by small business loans or credit card receivables generally could not be registered for sale on a delayed basis, and sold as market conditions warrant. The revisions to Form S–3 removed unnecessary regulatory obstacles to the raising of capital and should reduce the costs of securitizing a variety of financial assets, including pools of small business loans. By utilizing proven techniques of securitization that have been developed in connection with mortgage-backed securities, the Commission has sought to enhance significantly liquidity for lenders to small businesses.

While it is still too early to tell what effect these measures will have, we are aware of at least two proposed offerings eligible for shelf registration currently pending with the Commission that would pool small business loans and sell securities backed by those loans.[35] Meanwhile, we have been informally told by many on Wall Street that these initiatives should materially improve the efficiency of the structured finance market. Financial institutions may be able to make new loans to more small businesses if they can sell existing "securitized" loans to third parties.

Small Business Incentive Act of 1993

I will now turn to the Small Business Incentive Act of 1993. This legislation is very similar to the legislation submitted to the Congress by the Commission last April, and introduced as the Small Business Incentive Act of 1992.[36] The legislation principally would amend the Investment Company Act to streamline the regulation of venture capital pools that otherwise would be subject to the full bore of regulation under the Investment Company Act. The Commission believes that these changes are necessary because companies regulated under the Investment Company Act are subject to a number of rigorous requirements ranging from registration to restrictions on capital structure and dealings with affiliated persons.

Venture capital pools often find it difficult to comply with the Investment Company Act's capital structure restrictions. For example, while the Investment Company Act requires conventional closed-end funds to have a minimum of $3 of assets for every $1 of debt,[37] venture capital pools are usually highly leveraged. The capital structure of venture pools typically are more complex than that permitted by the Investment Company Act, which only permits closed-end funds to issue one class of debt securities and one class of preferred stock.[38] These pools also find it difficult to comply with the Investment Company Act's restrictions on dealings with affiliated persons, including the prohibition against joint transactions (absent ex-

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[29] 15 U.S.C. § 80a–3(c)(5).

[30] *See* Division of Investment Management, SEC, *The Treatment of Structured Finance Under the Investment Company Act*, PROTECTING INVESTORS: A HALF CENTURY OF INVESTMENT COMPANY REGULATION 68–73 (1992).

[31] Investment Company Act rule 3a–7, 17 C.F.R. § 270.3a–7. *See* Exclusion from the Definition of Investment Company for Structured Financings, Investment Company Act Release No. 19105 (Nov. 19, 1992), 57 FR 56248 (Nov. 27, 1992).

[32] *Id.*

[33] 17 C.F.R. § 230.415. *See* Simplification of Registration Procedures for Primary Securities Offerings, Securities Act Release No. 6964 (Oct. 22, 1992), 57 FR 48970 (Oct. 29, 1992).

[34] *Id.* at 48976.

[35] Fremont Funding Inc., Form S–3, Registration No. 33–55424 (filed Jan. 15, 1993); TMS SBA Loan Trust 1993–1, Form S–11, Registration No. 33–58126 (filed Feb. 10, 1993).

[36] S. 2518, 102d Cong., 2d Sess. (1992); H.R. 4938, 102d Cong., 2d Sess. (1992).

[37] Investment Company Act § 18(a)(1)(A), 15 U.S.C. § 80a–18(a)(1)(A).

[38] Investment Company Act § 18(c), 15 U.S.C. § 80a–18(c).

emptive relief from the Commission).[39] Unlike traditional investment companies, venture capital pools often control the companies in which they invest. In addition, several venture capital pools may be advised by the same persons. As a result of these relationships, joint transactions among affiliated venture capital pools are common, but would not be permitted by the Investment Company Act.

The proposed legislation would enable various types of venture capital pools to operate more freely. I will briefly discuss various types of venture capital pools.

Qualified Purchaser Investment Pools (sections 201–203). Section 202 would amend the Investment Company Act to permit a new genre of investment pools whose securities are owned exclusively by sophisticated or so-called "qualified" purchasers. The new exception would apply irrespective of the number of investors. At present, venture capital firms may avoid the Investment Company Act only if they limit the number of shareholders to 100 and only if they do not publicly offer their securities.[40] The 100 investor limit applies regardless of the financial sophistication of the investors involved. The proposal is designed to promote capital participation in venture capital funds by recognizing that sophisticated investors can appreciate the risks associated with pooled investment vehicles, and do not need Investment Company Act protections. In other words, these investors should be able to monitor on their own behalf such matters as management fees, transactions with affiliates, governance, investment risk, and leverage. By limiting participation in the new funds to sophisticated investors, the amendment could respond to the capital needs of small businesses without jeopardizing investor protection.

Funds relying on the new exemption would have greater access to the capital markets because they would be permitted to make public offerings.[41]

The legislation would assign to the Commission the responsibility of defining by rule the class of sophisticated or "qualified purchasers" eligible to invest in the new pools. In response to the legislation last April, the Commission suggested that, at least initially, the definition of "qualified institutional buyer" in Rule 144A under the Securities Act[42] would be an appropriate standard for institutional participants.[43] The Commission also indicated that it would propose standards requiring a high degree of financial sophistication for any natural person investing in the new pools comparable to their institutional counterparts.[44]

Business Development Companies (sections 206–210). Business development companies, or "BDCs," are domestic closed-end funds that invest in small and developing businesses. They were made possible by amendments to the Investment Company Act in 1980.[45] Unlike traditional investment companies that invest "passively" in so-called "small cap" stocks, BDCs are required by the Investment Company Act to offer significant managerial assistance to the companies in which they invest.[46]

The Commission regulates BDCs in a manner similar to registered investment companies. BDCs, however, technically are not required to register with the Commission as investment companies and generally are permitted greater flexibility in dealing with their portfolio companies,[47] issuing and pricing securities,[48] and compensating their management.[49]

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[39] Investment Company Act § 17(d), 15 U.S.C. § 80a–17(d).

[40] Investment Company Act § 3(c)(1), 15 U.S.C. § 80a–3(c)(1).

[41] The securities offered would be subject to the registration requirements of the Securities Act, unless the offering qualified for an exemption under that Act. *See* Securities Act § 5, 15 U.S.C. § 77e. Brokers or dealers offering the securities also would need to be registered under the Exchange Act. *See* Exchange Act § 15(a), 15 U.S.C. § 78o(a).

[42] 17 C.F.R. § 230.144A. Qualified institutional buyers generally include certain types of institutional purchasers that own and invest on a discretionary basis at least $100 million in securities, any registered dealer that owns and invests on a discretionary basis at least $10 million in securities, any registered investment company that is part of a family of investment companies with at least $100 million in securities, and any bank or savings and loan that owns and invests at least $100 million and has an audited net worth of at least $25 million.

[43] 138 CONG. REC. S4822 (daily ed. Apr. 2, 1992) (Memorandum of the Securities and Exchange Commission in Support of the Small Business Incentive Act of 1992).

[44] *Id. Cf.* the "accredited investor" standard of Regulation D under the Securities Act, 17 C.F.R. § 230.501(a) (an accredited investor generally includes natural persons with an individual income of only $200,000 or joint income with a spouse of over $300,000) *(emphasis added).*

[45] SMALL BUSINESS INVESTMENT INCENTIVE ACT OF 1980, Pub. L. No. 96–477, 94 Stat. 2275 (codified in scattered sections of 15 U.S.C.).

[46] *See* Investment Company Act § 2(a)(48), 15 U.S.C. § 80a–2(a)(48).

[47] *See, e.g.,* Investment Company Act rule 57b–1, 17 C.F.R. § 270.56b–1 (permitting BDCs to engage in principal transactions with controlled portfolio companies).

[48] *See, e.g.,* Investment Company Act § 63(2), 15 U.S.C. § 80a–62(2) (permitting BDCs to issue their securities at a price below net asset value under certain conditions).

[49] *See, e.g.,* Investment Company Act §§ 57(n), 61(a)(3)(B), 15 U.S.C. §§ 80a–56(n), –60(a)(3)(B) (permitting BDCs to establish profit-sharing plans for their directors, officers, and employees).

Although they were conceived of as a public alternative to private venture capital firms, BDCs have not proven particularly popular. In 1992, there were only about 49 active BDCs with assets of about $2.4 billion.[50] Sections 206 through 210 of the proposed legislation are designed to make it easier and less costly for BDCs to offer securities and to invest in small businesses.

Sections 206 through 208 would create a new class of very small companies in which BDCs could invest and would relieve BDC management from making available significant managerial assistance to these companies. The Commission has been told that the time and expense involved in making managerial assistance available deters BDCs from investing in these very small companies, which often are the ones most in need of capital. This new class would include any company that has total assets of $4 million or less and capital and surplus of $2 million or less. These numbers are derived from two of the minimum requirements for listing on NASDAQ.[51] By waiving the managerial assistance requirement for investments in this new class of company (or to any other company that meets criteria prescribed by Commission rule), the amendment seeks to encourage greater BDC participation in small businesses.

Section 208 would amend the Investment Company Act to permit BDCs to acquire more freely the securities of portfolio companies from persons other than the portfolio companies and their affiliated persons. Currently, BDCs must monitor their portfolios to assure that at least 70 percent of their assets are invested in cash, securities of financially troubled businesses, and securities of "eligible portfolio companies."[52] Eligible portfolio companies, to whom BDCs must offer their managerial assistance, are companies that do not qualify for margin listing under Federal Reserve Board regulations or companies that the BDC controls.[53] Currently, BDCs must acquire eligible portfolio company securities that do not qualify for margin listing directly from the companies or their affiliated persons.[54] The amendment would permit BDCs to acquire these securities from anyone.

Expanding the channels through which BDCs would be permitted to acquire small business securities should increase the liquidity of the securities, and perhaps make them more attractive as investments. The amendment also may enable BDCs to provide capital to a greater number of small businesses. For example, the legislation would permit BDCs to acquire the notes of small companies from financial institutions. BDCs then could sell the notes back to the companies in exchange for equity interests in the companies, thereby relieving the companies of debt.

Section 209 would permit BDCs greater flexibility in their capital structure. As such, this section would depart more profoundly from a central tenet of the Investment Company Act than any other amendment to that Act in the 53 years since its adoption. Congress should be aware that the highly capitalized and simplified "plain vanilla" capital structure the Investment Company Act now requires of investment companies was regarded a half-century ago as being of central importance to the protection of investors.[55] Nonetheless the Commission supports these amendments because it has been persuaded that without them BDCs will continue to be unable to attract the interest of venture capitalists. The safeguards in the proposed amendments should give reasonable projection to investors in these pools.[56]

Section 209 first would amend the Investment Company Act to permit BDCs to be more highly leveraged. BDCs currently are subject to a 200 percent asset coverage requirement.[57] They can issue only $1 of debt for every $2 in assets. The leg-

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[50] *See supra* note 5.

[51] The "National Association of Securities Dealers Automated Quotations System." Sections 1(c)(2) and 1(c)(3) of Part II to Schedule D of the National Association of Securities Dealers bylaws.

[52] Investment Company Act § 55(a), 15 U.S.C. § 80a–54(a).

[53] Investment Company Act § 2(a)(46), 15 U.S.C. § 80a–2(a)(46).

[54] *See* Investment Company Act § 55(a), 15 U.S.C. § 80a–54(a).

[55] Participants in the Congressional hearings in 1940 that led to the enactment of the Investment Company Act frequently referred to excessive leveraging and complex capital structures as some of the principal abuses in the investment company industry, because these practices led to personal gain for insiders at the expense of public shareholders, unfair valuation of securities, and disproportionate voting rights. *See Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 76th Cong., 3d Sess. 37–38, 44, 46, 270–71, 280 (1940). In adopting the Investment Company Act, Congress also identified "excessive borrowing and the issuance of excessive amounts of senior securities" as one of the principal abuses the Act was designed to address. *See* Investment Company Act § 1(b)(7), 15 U.S.C. § 80a–1(b)(7).

[56] Commissioner Roberts opposes the legislative expansion of BDCs. Given the Commission's enforcement experience with these organizations, he is of the opinion that their expansion may be destructive to the small company capital formation system.

[57] Investment Company Act §§ 18(a)(2), 61(a)(1), 15 U.S.C. §§ 80a–18(a)(2), –60(a)(1).

islation would reduce this asset coverage requirement to 110 percent ($1 of debt for every $1.10 in assets), under conditions designed to assure that servicing the debt is a reasonable prospect for the BDC. Specifically, BDCs taking advantage of the reduced asset coverage would be required to show a total interest and dividend income for the past 12 months that exceeds 120 percent of their total expenses and dividends declared for that period.

In addition, section 209 would permit BDCs to issue, without restriction, multiple classes of debt securities. BDCs currently may issue more than one class of debt only if all their debt securities are privately held or guaranteed by financial institutions.[58] The amendment would permit public investors to participate in offerings of multiple classes of debt.

Section 209 also would allow BDCs for the first time to issue, on a stand-alone basis, warrants, options, or rights that expire up to ten years from issuance. Currently, BDCs are permitted to issue warrants, options, or rights that expire more than 120 days but less than ten years from issuance only if they are accompanied by debt securities.[59] The Commission has been unable to find a basis for this restriction.

To address the additional risks associated with the proposed capital structure amendments, section 210 would grant the Commission authority to require BDCs to supply shareholders annually with a written statement describing the risk factors associated with the capital structures. This new authority would enable the Commission to ensure that investors are given adequate information about a BDC's capital structure.

BIDCOs and Intrastate Closed-End Funds (sections 204 and 205). The Small Business Incentive Act also includes two initiatives that affect "single state" investment companies. Section 204 would facilitate the creation and operation of state regulated business and industrial development companies, or "BIDCOs." Section 205 would update the current Investment Company Act exemption for intrastate closed-end funds.

BIDCOs are designed to provide capital, and sometimes managerial assistance, to businesses located within a particular state. BIDCOs typically provide capital through direct investments or loans. While BIDCOs may assist a variety of different types of businesses, the businesses often are small, local concerns.

At least 44 states have state statutes providing for the creation of these entities.[60] Of course, these statutes vary greatly. Some are comprehensive, imposing capital requirements, conflict of interest prohibitions, and other investor protections,[61] while others are more procedural in nature, merely empowering these entities to promote the growth of businesses within the state.

Because of their extensive investments in securities, BIDCOs also frequently are subject to the Investment Company Act. The Commission has used its exemptive authority to exempt 14 BIDCOs from some or all provisions of the Investment Company Act.[62] The exemptive process costs time and money, which may discourage the formation of some—especially smaller—BIDCOs. Section 204 would eliminate the need for individual exemptions by creating a self-operative exemption in the Investment Company Act.

The bill would require the BIDCO's operations to be regulated by a specific state statute. To address variations in state statutes or other concerns that may arise,

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[58] Investment Company Act § 61(a)(2), 15 U.S.C. § 80a–60(a)(2).

[59] Investment Company Act §§ 18(d), 61(a)(3)(A), 15 U.S.C. §§ 80a–18(d), –60(a)(3)(A).

[60] *See, e.g.*, Del. Code Ann. tit. 5, §§ 3301–3355 (Supp. 1992); Tenn. Code Ann. §§ 45–8–201 to –225 (1991).

[61] *See, e.g.*, Mich. Stat. Ann. §§ 23.1189(101) to –(1001) (Callaghan 1991).

[62] *See* The Idaho Company, Investment Company Act Release No. 18985 (Sept. 30, 1992); Arcadia BIDCO Corporation, Investment Company Act Release No. 16141 (Nov. 20, 1987); Valley Opportunities Inc., Investment Company Act Release No. 16037 (Oct. 6, 1987); Universal BIDCO Corp., Investment Company Act Release No. 15444 (Nov. 28, 1986); Indiana Community Business Credit Corp., Investment Company Act Release No. 14585 (June 18, 1985); Development Corporation of Montana, Investment Company Act Release No. 14122 (Sept. 4, 1984); New Mexico Business Development Corporation, Investment Company Act Release No. 13930 (May 7, 1984); Business and Industrial Development Corporation of Washington, Investment Company Act Release No. 7301 (July 28, 1972); Iowa Business Development Corporation, Investment Company Act Release No. 5585 (Jan. 23, 1969); Utah Business Development Corporation, Investment Company Act Release No. 5518 (Oct. 18, 1968); Colorado Business Development Corporation, Investment Company Act Release No. 4524 (Feb. 24, 1966); Kansas Development Credit Corporation, Inc., Investment Company Act Release No. 4319 (Aug. 9, 1965); RIDC Industrial Development Fund, Investment Company Act Release No. 4135 (Jan. 12, 1965); Pennsylvania Development Corporation, Investment Company Act Release No. 3965 (Apr. 28, 1964). Of course, other BIDCOs that can rely on one of the Investment Company Act's exemptions would not have needed or received an exemptive order.

the Commission would have the authority, by rule or order, to impose conditions it deems necessary or appropriate to protect investors.

The legislation specifically would require that at least 80 percent of each offering of the BIDCO's securities would have to be sold to residents of the state where the BIDCO conducts its operations. This requirement should help assure a state's regulatory interest in BIDCOs located within the state. The 20 percent cushion for out-of-state sales also would provide flexibility for any "spill-over" sales that might occur, especially in offerings conducted in metropolitan areas that overlap several states.

In addition to other investor protection requirements detailed in the legislation, all BIDCO security holders would have to qualify as "accredited investors" under the Securities Act, or meet such other standard as the Commission may authorize by rule or order.[63]

The second "single state" initiative involves closed-end funds that publicly offer their securities within a particular state. These funds may invest in businesses in the state where their security holders reside or in businesses located throughout the United States. Under section 6(d) of the Investment Company Act, the Commission, upon the filing of individual applications, may exempt these intrastate closed-end funds from the Investment Company Act so long as the aggregate proceeds raised in the public offering do not exceed $100,000.[64]

The $100,000 limit was put into place in 1940. This amount should be increased to reflect more accurately the current financial requirements of companies providing capital to small businesses and others. Section 205 of the legislation would bring the exemption into the 1990's by increasing the exemption's ceiling to $10 million. It would permit the Commission to readjust this amount by rule or order.

Private Investment Companies (sections 201 and 203). As I mentioned earlier, private venture capital funds rely on the statutory exception for funds that do not have more than 100 investors and do not publicly offer their securities. This provision is found in section 3(c)(1) of the Investment Company Act.[65]

The 100 investor limit is calculated through a complex test. Because of this test, private funds must be particularly vigilant about the purchase of their securities by corporate investors. When a company purchases 10 percent or more of a private fund's securities, that company's security holders may be counted toward the 100 investor limit.[66] If the 100 investor limit is exceeded, the fund would be subject to the full panoply of Investment Company Act regulation. Private venture capital funds, as a practical matter, may avoid this problem by limiting investments by corporate investors to less than 10 percent of the private fund's securities. Limiting corporate investments, of course, constrains the fund's capital growth and the availability of funds for investment in small businesses.

Section 201 of the bill would simplify the way in which the 100 investor limit is calculated. The proposal would no longer count—under any circumstances—the security holders of corporate, non-investment company investors. The practical effect would be to eliminate current constraints on corporate investments in private venture capital funds. This could potentially make new capital available to small businesses without any serious risk to investors.

The legislation, however, would apply the 10 percent limit to investments by a registered investment company in any one private fund. This would ensure that registered funds could not use private funds to circumvent application of the Investment Company Act.

Even with the new "qualified purchaser" investment company we are recommending, section 3(c)(1) will continue to be important for venture capital funds and other pooled investment vehicles whose securities are not held exclusively by qualified purchasers.

Securities Act Exemptive Authority. Finally, the Commission currently is authorized to exempt from the registration provisions of the Securities Act offerings of $5 million or less.[67] The Commission has used this authority to create several exemptions, including an exemption for small public offerings (Regulation A)[68] and an exemption for certain employee benefit plans (rule 701).[69] Section 101 would permit

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[63] The proposed "accredited investor" requirement would be appropriate for the BIDCO exemption since the exemption would be limited to a specific type of issuer and would rely on state law to provide alternative regulatory protections.

[64] 15 U.S.C. § 80a-6(d). *See, e.g.,* Associated Life Insurance Corp., Investment Company Act Release No. 4574 (Apr. 22, 1966).

[65] 15 U.S.C. § 80a-3(c)(1).

[66] Investment Company Act § 3(c)(1)(A), 15 U.S.C. § 80a-3(c)(1)(A).

[67] 15 U.S.C. § 77c(b).

[68] 17 C.F.R. § 230.251-263.

[69] 17 C.F.R. § 230.701.

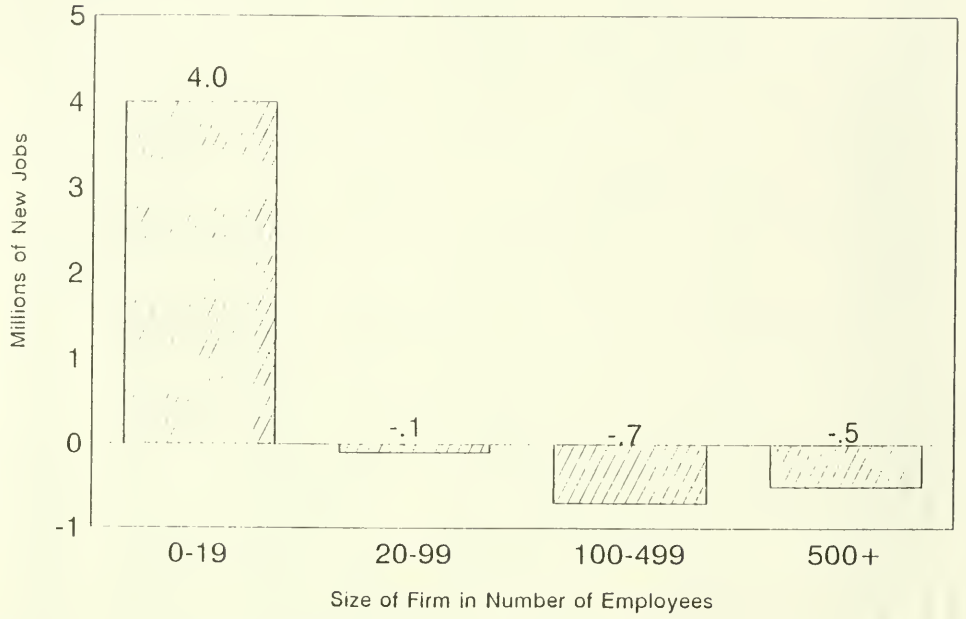
the Commission to exempt from registration offerings of up to $10 million. This would enable the Commission to extend the benefits of its exemptive rules to more business financings, including small business financings.

Conclusion

The proposed legislation combines a variety of provisions, some breaking new ground, some updating and refining existing practice. The Commission believes that, taken together, this package of reforms may help increase the flow of capital to small businesses without creating inappropriate risks to investors.

The Commission stands ready to assist the Subcommittee in this endeavor.

Figure A
Job Creation by Firm Size, 1988-1990



Source: U S. Small Business Administration, The State of Small Business: A Report of the President 47 (1992).

Figure B
Number and Assets of Active BDCs and SBICs
1991-1992

	BDCs	SBICs
No. in 1992	49	11
No. in 1991	48	10
1992 Assets (in Billions)	$2,358.7	$331.8
1991 Assets (in Billions)	$2,463.9	$290.5

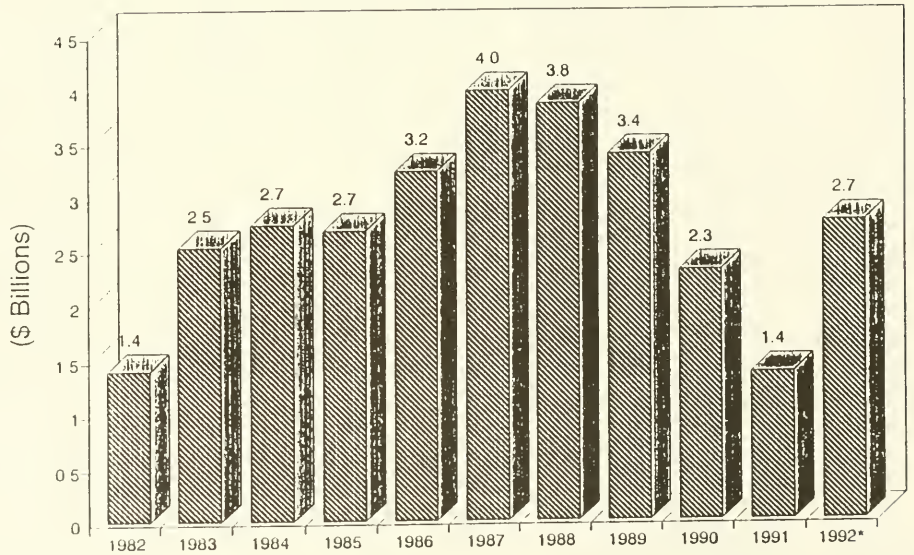
Source: Commission Records

Figure C
Growth in Small Company Open-End Mutual Funds
1991-1992

	September 1992	September 1991
No. in 1992	148	107
Assets (in Billions)	$22.1	$16.1
Net Sales (in Billions)	$3.6	$1.2

Source: Lipper Analytical Services Inc., Lipper Director's Analytical Data, Vol. II-A (4th eds.1991 and 1992).

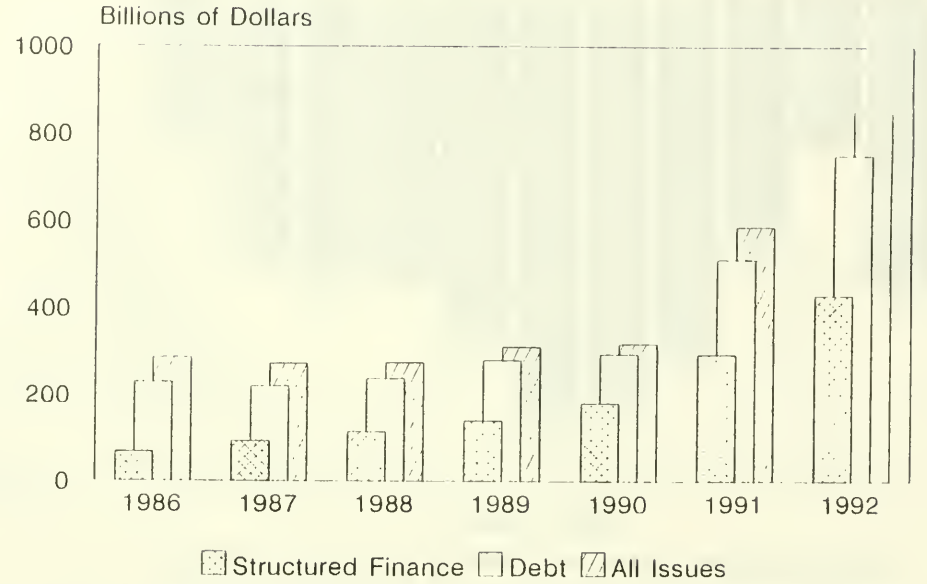
Figure D
Disbursements From Venture Capital Firms
1982-1992



* Annualized from the first six months.

Source: Venture Capital Journal, June 1992, 27 (Venture Economics Publishing Co.).

Figure E
Comparative Data Reflecting
Growth of Structured Finance in the United States 1986-1992



Sources: How Sweet It Was, Inv. Dealers' Dig., Jan. 11, 1993 at 14, 17-18; Michael Liebowitz, Reversing a four-year trend and swooning economy, Wall Street explodes in 1991, Inv. Dealers' Dig., Jan. 6, 1992 at 16, 26-27; Abby Schultz, Risk Enters the Picture in 1989, Jan. 8, 1990 at 26, 35-36; Evan Guillem, Who Survived the Crash?, Inv. Dealers' Dig., Jan. 11, 1988 at 19, 29

STATEMENT OF BARRY C. GUTHARY

PRESIDENT, NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

DIRECTOR, MASSACHUSETTS SECRETARY OF STATE'S, DIVISION OF SECURITIES

Executive Summary

Recognizing that small businesses play a vital and indispensable role in our nation's economy, state securities regulators—individually and collectively through NASAA—have devoted considerable time and energy over the last several years to developing innovative and creative approaches to ease the way for legitimate small business capital formation in the U.S. Securities agencies across the country either already have or are now in the process of putting in place the Small Corporate Offering Registration (SCOR), a streamlined question-and-answer registration process allowing small firms to raise up to $1 million in a 12-month period. While SCOR may not have been the first small business capital formation innovation in U.S. securities law, it does represent a "summing up" of the lessons learned in earlier efforts. SCOR involves the explicit recognition that small business capital formation initiatives, if not carefully crafted, may end up serving as a vehicle for swindles, just as the penny stock market in the mid and late 1980s came to be dominated by fraud.

The comments NASAA offers here today with respect to federal small business capital formation initiatives are based both on our substantive experience in this area and on our years of experience in serving as the front line protection for small investors. As discussed in more detail in the full statement, NASAA generally supports most of the key concepts of the proposed "Small Business Incentive Act." However, an initial review of the proposed "Small Business Loan Securitization and Secondary Market Enhancement Act" has raised serious concerns among NASAA's members and, as a result, we respectfully suggest that consideration of this proposal be postponed pending further study. Many of the issues of interest to NASAA with respect to developing a secondary market for loans to small businesses now are being explored by representatives of the Treasury Department, the Congressional Budget Office, the Securities and Exchange Commission and the Small Business Administration. NASAA respectfully suggests that this Subcommittee postpone further action on this measure until this report is made available.

NASAA appreciates this opportunity to offer its views to the Subcommittee and looks forward to working closely with this Subcommittee as you move forward to refine and further review the issues involved in the proposed small business measures.

Mr. Chairman and Members of the Subcommittee: My name is Barry C. Guthary. I am president of the North American Securities Administrators Association (NASAA) and director of the Massachusetts Secretary of State's Division of Securities. In the U.S., NASAA is the national voice of the 50 state securities agencies responsible for investor protection and the efficient functioning of the capital markets at the grassroots level. I appreciate the opportunity to appear before you today.

As is discussed below in this statement, NASAA generally supports many of the key concepts of the proposed "Small Business Incentive Act." However, the Association has very real concerns about certain elements of the proposed "Small Business Loan Securitization and Secondary Market Enhancement Act" and respectfully recommends that consideration of this proposal be postponed to allow for further study and examination of the issues raised in this statement. In addition to discussing the specific elements of the two proposed measures, NASAA also offers for this Subcommittee's consideration and understanding details on state efforts to promote legitimate small business capital formation, as well as information concerning small business and the capital markets.

OVERVIEW

While capital raising in the 1980s often meant junk bonds, leveraged buyouts and other high-rolling transactions, the emphasis today has shifted to the financing needs of the small businesses responsible for the vast majority of the new expansions and start-ups yielding new jobs, markets, innovations and tax revenues in the U.S. economy. Recognizing that small businesses play a vital and indispensable role in our nation's economy, state securities regulators—individually and collectively through NASAA—have devoted considerable time and energy over the last several years to developing innovative and creative approaches to ease the way for legitimate small business capital formation in the U.S. The comments we offer here today with respect to federal small business capital formation initiatives are based both on our substantial experience in this area and on our years of experience in serving as the front line protection for small investors.

Securities agencies in states across the country either already have or are now in the process of putting in place the **Small Corporate Offering Registration** (SCOR), a streamlined question-and-answer registration process allowing small firms to raise up to $1 million in a 12-month period. While SCOR may not have been the first small business capital formation innovation in U.S. securities law, it does represent a "summing up" of the lessons learned in earlier efforts. Some of the other federal and state programs designed to ease access to the capital markets for new and growing firms were found in practice to be too complex, overly restrictive or even plagued with fraud and other abuses. SCOR involves the explicit recognition that small business capital formation initiatives, if not carefully crafted, may end up serving as a vehicle for swindles, just as the penny stock market in the mid and late 1980s came to be dominated by fraud.

State securities regulators understand perhaps better than anyone else the delicate balance that must be arrived at between investor protection and capital formation. A loosely-constructed or ill-defined approach to capital formation could jeopardize investors, and by extension, the still fragile economic recovery. One needs to look no further than Colorado, where extensive and uncritical deregulation was touted in the early 1980s as the key to small business capital formation. However well intentioned, that move to deregulation opened up Colorado to massive penny stock fraud. Investors were burned, lost confidence in the fairness of the markets and decided to "sit on the sidelines" when it came to investing. The end result was exactly the opposite of what Colorado lawmakers had set out to do.[1]

Mr. Chairman, no one set out deliberately to create the problems in the investment marketplace of the 1980s, but they happened because of the gap between good intentions and the right specifics. It is one thing to come out in favor of the "motherhood, baseball, and apple pie" proposition of small business capital formation; it is quite another thing to frame a plan that will get scarce capital resources into the hands of new and expanding firms and keep it out of the pockets of those who would inflict costly fraud and abuse on the investing public. It is through this prism that the benefits of any investment deregulatory initiative—no matter how well-intentioned—should be judged.

FEDERAL SMALL BUSINESS INITIATIVES

The Subcommittee now has before it two proposals intended to facilitate access to the public capital markets for start-up and developing companies and to lower the costs for small businesses that undertake to have their securities traded in the public market. Mr. Chairman and Members of the Subcommittee, NASAA appreciates this opportunity to offer its views on the proposed legislation. As mentioned earlier, NASAA generally is supportive of the proposed "Small Business Incentive Act of 1993," but we have serious reservations about the "Small Business Loan Securitization and Secondary Market Enhancement Act of 1993," which we respectfully recommend undergo further study and review before moving forward. NASAA is prepared to provide any assistance that is desired by this Subcommittee as you refine and further consider these legislative initiatives. Specific comments on both proposals follow.

The Small Business Incentive Act of 1993

The Small Business Incentive Act of 1993 would amend the Securities Act of 1933 to provide greater regulatory flexibility to the Securities and Exchange Commission and would amend the Investment Company Act of 1940 with respect to excepted or exempt investment companies. NASAA's comments on each of the key provisions follow.

- *Securities Act Exemptive Authority.* Section 101 of the proposed legislation would increase from $5 million to $10 million the Commission's authority to create exempt offerings from Securities Act registration. *NASAA is pleased to support this increase in the size of the small offerings that could be exempt from registration under Section 3(b) of the Securities Act.* In fact, NASAA is interested in exploring with the Commission a further extension of the concept already embodied in federal securities laws whereby the states serve as the primary reviewer of smaller, local public offerings.
- *Private and Qualified Investment Companies.* Sections 201 and 202 of the proposed legislation would create a new class of less regulated mutual funds geared to supplying venture capital. The Commission has stated that it believes that

[1] In 1990, the Colorado General Assembly took major steps to reverse the deregulation of the early 1980s and to improve investor confidence by adopting legislation giving important new powers to the state's Securities Division so that it could more effectively oversee the securities industry.

these proposed changes would help create or expand sources of small business financing without creating the type of risks to public investors that the Investment Company Act originally was designed to address. Investment pools created pursuant to this new section 3(c)(7) of the 1940 Investment Company Act would not have a limitation on the number of investors and there would be no prohibition on public offerings.

Qualified Purchasers. Section 201 of the proposed bill would create a new exception in the Investment Company Act for investment pools whose securities are held exclusively by qualified purchasers. Qualified purchasers, under Section 202 of the bill, would be defined by Commission rule on the basis of financial sophistication, net worth, knowledge and experience in financial matters, amount of assets owned or under management, relationship with an issuer, and other relevant factors. Testifying before this Subcommittee last year, SEC Chairman Breeden indicated that, "at least initially, the Commission probably would define 'qualified purchaser' under this section more or less as it has defined 'qualified institutional buyer' under Rule 144A under the Securities Act."[2] As a result of this exception, these sophisticated investors would be free to participate in investment pools that are not subject to the requirements of the Investment Company Act designed for retail investors. It is hoped that such an exception would increase the flow of funds into venture capital companies, and from there into small business enterprises. *NASAA supports this provision, but would emphasize that the SEC, in its rulemaking, should put in place the high standards it has articulated for the definition of qualified purchaser.*

Liberalization of provisions relating to private investment companies. The bill would amend Section 3(c)(1) of the 1940 Act to eliminate current restrictions on corporate (non-investment company) investments in "private investment companies." Private investment companies are investment pools that do not have more than 100 investors and do not engage in public offerings. A corporate investment would be treated as one investor for the purposes of calculating the 100 investor limit. *NASAA supports this amendment to the Investment Company Act.*

Permissible investments in private investment companies. The SEC's explanation of amended Section 3(c)(1) of the 1940 Act states, in part, that it would "enable registered investment companies to invest up to 10 percent of their assets in [private investment companies]." However, it is unclear to us exactly how this is accomplished. *NASAA's concern is that what actually may be contemplated would be to permit a registered investment company to invest up to 10 percent of ITS assets in private investment companies.* If that is the case, NASAA suggests that such private investment company securities would be very illiquid, which may lead to redemption problems. Further, the private investment companies would not be as closely regulated under the 1940 Act as are registered companies, the result of which may be increased opportunities for abuse and risk which are not appropriate to flow through to the registered investment company. Perhaps once this point is clarified we will find that there is no reason for concern.

- *Intrastate closed funds.* Today, certain small closed-end funds may avoid regulation under the Investment Company Act of 1940 by offering their securities only to residents of the state in which they are organized. Under current law, these funds may not raise more than $100,000 from investors. Section 205 of the proposed legislation would amend Section 6(d)(1) of the Investment Company Act to increase from the current $100,000 to $10 million the maximum aggregate amount permitted to be received from intrastate securities offerings of a closed-end investment company. Increasing the aggregate offering limit here is intended to make it less costly to form and expand "single state" investment companies, which it is hoped, in turn will provide capital for small, local businesses. Importantly, investors would continue to be protected by state securities laws. *NASAA supports this provision.* NASAA encourages the Subcommittee to include in its report language, direction to the SEC to interpret these provisions liberally. At present, the SEC's rules have made the intrastate exemption contained in the 1933 Act virtually unuseable in the mid-Atlantic/Northeast region.
- *Business and Industrial Development Companies.* At least 45 states have authorized the creation of a "business and industrial development company" (BIDCO), for the purpose of providing financial and, in some cases, managerial assistance to business concerns located within the state. Under current law, BIDCOs must register their securities with the Commission under both the Securities Act and the Investment Company Act, though exemptions may be available under the Se-

[2] *See,* Testimony of Richard C. Breeden, Chairman, U.S. Securities & Exchange Commission, "Concerning Small Business Finance," before the Subcommittee on Securities, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, March 26, 1992, footnote 22, page 12.

curities Act and are granted on a case-by-case basis under the Investment Company Act.

Section 204 of the legislation proposes to amend Section 6(a) of the Investment Company Act by adding a new subsection (5) which would, under certain conditions, exempt BIDCOs from regulation under the 1940 Act. There are several proposed restrictions, including: (1) the securities may only be distributed to accredited investors (or other persons as determined by SEC rule or order); and (2) 80 percent of the BIDCO's securities, on a class-by-class basis, must be held by persons who "reside in or have a substantial business presence in that state." *NASAA supports this provision.* The requirement that the securities be distributed only to accredited investors is a helpful investor safeguard.

- *Business Development Companies.* Business development companies (BDCs) are domestic closed-end funds that invest in small, developing and financially troubled businesses, and provide managerial assistance to these companies. Sections 207 through 210 of the proposed legislation would make various changes to the current regulation of these investment companies. *In general, NASAA supports these changes.*

Definition of eligible portfolio company. Section 206 would amend Section 2(a)(46) of the 1940 Act to expand the definition of "eligible portfolio company" to include any company that does not have total assets in excess of $4 million and surplus (shareholder's equity less retained earnings) in excess of $2 million. It is suggested that such an amendment would permit business development companies to invest in more small businesses, thus increasing the flow of capital to such enterprises. Whether or not this amendment actually does expand in any material way the definition of "eligible portfolio company" may be open for debate. Nonetheless, *NASAA supports this provision.*

Relaxation of managerial assistance requirements. Section 207 of the legislation would exempt various small portfolio companies from the current requirement that a BDC provide managerial assistance to their portfolio companies. The rationale here is that many small businesses may need financing, but not managerial assistance and that this provision would allow BDCs greater flexibility to invest in these companies. *NASAA supports this provision.*

Acquisition of assets by BDCs. The next proposed change in the regulation of business development companies is found in Section 208, which would amend Section 55 of the 1940 Act to permit a business development company to acquire securities of an eligible portfolio company from persons other than the eligible portfolio company subject to SEC rules. Although the effect of this change may be to dilute slightly the economic development impact of a BDC, *NASAA supports this change.*

Capital structure amendments. Section 209 of the proposed bill would amend Section 61(a) of the 1940 Act with respect to asset coverage requirements for debt securities. The proposal here would be, in certain circumstances, to decrease the asset coverage requirement from the current 200 percent to 110 percent. The section-by-section analysis of this provision concludes: "The amendment would permit business development companies to be more highly leveraged, thus allowing additional investment in small businesses." *NASAA takes no position on this proposed change, pending further review.*

Section 209 also would amend Section 61(a)(2) of the 1940 Act to permit a business development company to issue, without restriction, multiple classes of debt securities. Under current law and regulations, there are fairly substantial limitations with respect to issuing more than one class of securities. This Section of the 1940 Act is further amended to allow a business development company to issue warrants, options and rights, under certain conditions. It is hoped that such a change would provide business development companies with flexibility in their capital structure. *NASAA takes no position on either of these proposed changes.*

Improved disclosure. Section 210 of the bill would amend the Investment Company to require a business development company to file with the SEC and to provide annually to shareholders a written statement describing the risk factors associated with the company's capital structure. *NASAA strongly supports this provision* to enhance the disclosure to investors, especially in view of the fact that the other proposed amendments included in this bill would make the capital structure more flexible, and possibly more risky.

Small Business Loan Securitization and Secondary Market Enhancement Act

Mr. Chairman, Senator D'Amato, and other Members of the Subcommittee, NASAA shares your interest in exploring new ways to facilitate small business capital formation. We recognize that the proposed "Small Business Loan Securitization

and Secondary Market Enhancement Act" is a direct outgrowth of your interest in developing innovative approaches to getting funds into the hands of the small business persons who have suffered under the "credit crunch." The legislation you have introduced is modeled after the "Secondary Mortgage Market Enhancement Act," which, through the securitization of home mortgage loans, has been credited with playing a key role in maintaining a continuing flow of bank credit to the residential housing sector of our economy.

However, *an initial review of this legislation has raised serious concerns within NASAA and therefore, we respectfully suggest that consideration of this proposal be postponed pending further study.* In addition, Subtitle B, Section 311 of the "Small Business Credit and Business Opportunity Enhancement Act of 1992,"[3] signed into law on September 4, 1992, directs the Secretary of the Treasury, the Director of the Congressional Budget Office, and the Chairman of the Securities and Exchange Commission, in consultation with the Administrator of the Small Business Administration, to conduct a study of the potential benefits of, and legal, regulatory, and market-based barriers to, developing a secondary market for loans to small businesses. Among the issues to be studied are:

- Market perceptions and the reasons for the slow development of a secondary market for loans to small businesses;
- Means by which to standardize loan documents and underwriting for loans to small businesses relating to retail and office space;
- The probable effects of the development of a secondary market for loans to small businesses on financial institutions and intermediaries, borrowers, lenders, real estate markets, and the credit markets generally;
- Legal and regulatory barriers that may be impeding the development of a secondary market for loans to small businesses; and
- The risks posed by investments in loans to small businesses.

It is NASAA's view that it would be premature for Congress to move forward with the "Small Business Loan Securitization and Secondary Market Enhancement Act" absent the type of information to be gathered in the study referenced above. As a result, NASAA respectfully recommends that consideration of the proposed "Small Business Loan Securitization and Secondary Market Enhancement Act" be postponed until Members of this Subcommittee and your staffs have had an opportunity to review the report mandated under the legislation approved by Congress last year.

NASAA's general concerns with the legislation are as follows:

- THERE ARE IMPORTANT DISTINCTIONS BETWEEN HOME MORTGAGE LOANS AND SMALL BUSINESS LOANS. Although the legislation in question is modeled after the Secondary Mortgage Market Enhancement Act[4] (SMMEA), there are critical distinctions between the two measures. First and foremost is the vastly different nature of the underlying securities. SMMEA dealt with a homogeneous underlying asset—home mortgages. Those mortgages also generally are insured by quasi-governmental agencies and have a high degree of collateralization. Small business loans on the other hand, have no standard format and vary widely in their collateralization. At a minimum, the bill should require the regulatory agencies to standardize the small business loans that would be put in the package and should require a minimum level of collateralization. Finally, we would point out that we now are beginning to see some of the potential problems associated with the secondary mortgage market. An article in the March 1, 1993, issue of Forbes magazine, "Alice in Mortgageland," concludes: *"By turning mortgages into tradeable securities, Wall Street made a wider pool of money available for home buyers, thus lowering the mortgage rates. That's good. But the unintended consequence was a market of such complexity that it put investors at the not so tender mercy of Wall Street houses . . . Thus, with deft mathematics, Wall Street and FNMA have created a huge unregulated securities market."*[5] *(emphasis added)*
- THE NEED FOR STATE PREEMPTION HAS NOT BEEN DEMONSTRATED. State securities agencies perform a critical function in protecting state residents from fraud and abuse in the capital markets. Preemption of that authority robs a state of the ability to protect its citizens and should be imposed in only the most extraordinary circumstances. NASAA respectfully suggests that proponents of the "Small Business Loan Securitization and Secondary Market Enhancement Act" have not met the burden of proof necessary here. As is the case under SMMEA, this proposal would preempt registration requirements under state securities laws for the sale of small business-related securities. States would be given a seven-year window in which to reassert their registration prerogatives.

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[3] Public Law 102–366.
[4] P.L. 98–440, 15 U.S.C. Section 77r–1.
[5] Laura Jereski, "Alice in Mortgageland," *Forbes,* March 1, 1993, pp. 46–48.

In 1984 testimony before the House Telecommunications and Finance Subcommittee on the subject of the then-proposed SMMEA, NASAA representatives suggested that, at a minimum, the state reassertion prerogative be extended from the proposed three years to an unlimited timeframe. While we did not get such an extension, we were successful in getting the states seven years in which to "opt out" of the preemption. It is our understanding that 10 states[6] did act within the allotted time period to reassert registration authority over mortgage-related securities. The Association fully expects that many more states would act to reassert authority over small business-related loans. While NASAA opposes any preemption of state authority in this area, if Congress determines to move forward, NASAA would recommend that the preemption of state authority be limited to state oversight of the sale of these offerings to institutional investors.

- LOWER GRADE SECURITIES ALLOWED UNDER THE PROPOSED LEGISLATION. SMMEA limited its scope to the top two investment grades. By contrast, the "Small Business Loan Securitization and Secondary Market Enhancement Act" would expand its scope to include the *top four* investment grades. By definition, medium grade investment bonds have no assurance of faring well in volatile economic times. If Congress is determined to move forward with this legislation, it should, at a minimum, limit its scope to the two highest quality investment grades and should *not* expand down into the medium grades.
- THE MEASURE WOULD SUBSTITUTE AMONG SERVICE "REVIEWS" FOR STATE REVIEWS. This legislation would appear to delegate governmental responsibilities to private businesses. It is not the function of a rating agency to police public offerings under regulatory provisions similar to those found in state and federal securities laws. The function of a rating agency is to pass judgement on the ability of the issuer to pay interest and principal when due. The scope of rating agency review, therefore, is much more narrow than of government officials who operate under investor protection mandates. Unlike a governmental agency, rating agencies generally are devoid of any public policy objectives or mandates to provide investor protection. In addition, we would point out that, over the last several months, there have been calls from both within Congress and the Securities and Exchange Commission for greater oversight of these ratings agencies. In a letter to House Energy and Commerce Committee John Dingell, SEC Commissioners Richard Roberts and Mary Shapiro observed that: *"Compared with the role that rating agencies play in the capital markets, the Commission receives relatively little about these entities and their operations."*[7] [8] *NASAA respectfully suggests that, absent increased oversight of their operations, rating agencies should not be given increased regulatory power over the capital markets.*

The State Experience

As mentioned above, much of the securities regulation in the U.S. is an ongoing effort to keep in balance the scales of "investor protection" and "capital formation." With too little emphasis on investor protection, the scales may tip in favor of a reoccurrence of something on the order of the multi-billion-dollar penny stock scams of the 1980s. If the scale of capital formation is "shorted," then the process of securities regulation may become burdensome and costly for small businesses seeking access to financing sources. Nowhere has this balancing act been more of a day-to-day fact of life than in state securities agencies, which are entrusted with overseeing both investor protection and the efficient functioning of the capital markets at the grassroots level in the United States.

The Emergence of SCOR

In the wake of the adoption by Congress of the Small Business Investment Incentive Act of 1980, the U.S. Securities and Exchange Commission (SEC) deferred to the states on oversight of many offerings of $1 million or less. State securities agencies responded with a variety of rules and exemptions to assist small businesses in their capital formation efforts. From this round of innovative efforts emerged an experiment in Washington State, where officials at the Securities Division of the Department of Licensing worked with members of the local securities bar to craft a simplified program allowing small businesses to make a public stock offering.

The goal in Washington state was to develop a streamlined disclosure document that an entrepreneur armed with a basic business plan could complete with only

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[6] The 10 states are Arkansas, Arizona, Indiana, Louisiana, Maryland, Minnesota, New Mexico, Oklahoma, South Dakota and Utah.

[7] As reported by Roger Fillion, "SEC Officials Clash Over Rating Agency Regulation," *Reuters*, August 13, 1992 (Executive News Service).

[8]

limited professional assistance and other costs. (The form also was to be intelligible to attorneys and accountants who are *not* securities specialists.) The State settled upon a simplified question-and-answer document. Once registered, *the completed form doubles as a prospectus.* This simplified disclosure process (1) greatly reduces the expenses associated with an offering, (2) sets out the basic information needed to comply with state and federal securities laws, and (3) anticipates the questions most often posed by individual investors, venture capitalists and investment bankers. Important safeguards have been put in place to address concerns that the SCOR program might be abused as a vehicle for fraudulent offerings. For example, the scope of permissible SCOR offerings has been narrowed somewhat and, as a result, blind pool offerings and penny stocks are not permitted. Likewise, SCOR is not open to any issuer who has been the subject of a range of specific law enforcement actions.

The Washington state program[9] was met with immediate interest on the part of eager small issuers. The innovative program in Washington state went national in April 1989 as the **Small Corporate Offering Registration** (SCOR),[10] which was adopted as a model for use by the membership of the North American Securities Administrators Association.[11]

Though there has been less than four years of nationwide experience with SCOR, it already is apparent that this new approach to addressing small business capital formation is catching on. Several states have followed in Washington state's footsteps, adding their own innovative twists to foster the further success of SCOR and other small business initiatives. Many state securities agencies are now establishing in-house small business assistance centers, seminar programs, and outreach to potential underwriters and major investors.

Today, NASAA and its members continue to explore new ways in which to facilitate legitimate small business capital formation under the SCOR program. For example, NASAA's Small Business Capital Formation Committee has been charged with studying the feasibility of moving to a *regional review system* for SCOR filings. The goal of this study is to determine whether such an approach would simplify the review process for issuers and at the same time address each state's regulatory concerns. Also, *the Pacific Stock Exchange has asked the SEC for permission to list smaller companies that go public through the SCOR process.* While this certainly is an intriguing proposal, NASAA recognizes there also are potential risks here. NASAA is looking at the proposal, but has not yet taken a position on this issue.

NASAA also is pleased that the Securities and Exchange Commission has adopted the SCOR form as an optional form for Regulation A filings of $5 million or less. Separately, NASAA is considering whether state-level regulations should be adjusted to allow for offerings of up to $5 million under the SCOR format. As the "laboratory of the states" brings forth additional success stories under SCOR (and other efforts designed to encourage small business capital formation), it will be shared through the network of state securities regulators that NASAA comprises. It also is our intention to continue to work cooperatively with the SEC to facilitate legitimate small business capital formation.

Small Business and the Capital Markets

Small business is the lifeblood of the American economy, with enterprises employing nine or fewer workers accounting for 75 percent of all business establishments in the U.S.[12] The concern that has emerged over the last several months that the small business sector of the 1990s will not match its powerful job-generating per-

[9] The state's innovative program was a recipient of the prestigious Arthur D. Little Excellence in Economic Development award in 1990.

[10] SCOR is variously referred to as Form U-7 (in recognition of the NASAA designation for the underlying uniform form), SCORF (Small Corporate Offering Registration Form), or ULOR (Uniform Limited Offering Registration). Individual states also may have their own titles for this program.

[11] Today, the following states either officially or unofficially have adopted the SCOR registration program or accept the filing of the SCOR form in certain instances: Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Georgia, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Massachusetts, Mississippi, Missouri, Montana, Nevada, New Hampshire, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Texas, Vermont, Virginia, Washington, West Virginia, Wisconsin and Wyoming. In addition, the states of Florida, Illinois, Michigan, Tennessee and Utah are in the process of adopting or intend to adopt SCOR.I77NEW DEVELOPMENTS

[12] *The State of Small Business: A Report of the President,* October 22, 1990, page 74.

formance of the 1980s [13] has fueled a flurry of legislative and other initiatives aimed at spurring growth in this sector. Some of the proposed new programs have been in the area of small business financing, both for new start-up enterprises and expansions of existing businesses.

While NASAA strongly supports responsible and prudent investment-related initiatives designed to ease small business capital formation, we also are aware that the vast majority of small businesses do not seek equity financing in order to start-up or expand their operations. A 1991 member survey by the Gallup Organization, Inc., of the membership of National Small Business United (NSBU) found that small business operators rely on the following sources of capital: [14]

	Percent
Personal resources	70
Loans from banks	37
Loans from friends, relatives	21
Profit/retained earnings	15
Loans from S&Ls	3
Other (including equity)	**Less than 1**

A survey of start-up capital sources for small businesses included in the March 1993 edition of *Entrepreneur* reported similar findings: Forty-seven percent of respondents said they used personal capital (including home equity loans) to finance their businesses; 27 percent received bank loans; and 25 percent of respondents relied upon private sources (family, friends and others) for their funding. Though equity financing may not figure currently as a prominent "piece" of the small business capital formation "puzzle," the question might be asked: Are small business operators clamoring for easier access to the equity markets? When the NSBU members were asked in the same recent survey to list the *"most important problems facing business,"* the small business operators ranked their key concerns as follows: [15]

	Percent
Health insurance costs/availability	57
Government regulations (e.g., environmental)	36
Federal taxes	36
Labor/payroll costs	33
State/local taxes	32
Competition from other small businesses	22
Capital availability (all types)	**21**
Labor quality/education/job training	20

Recent reports and statements from the U.S. Chamber of Commerce, Small Business Administration, National Federation of Independent Businesses, NSBU and other like-minded organizations make it clear that many small business concerns about capital availability center on the restrictive lending practices of banks. Typical calls for action from such groups include a reinstitution of the capital gains tax break (at least for long-term investments), an end to any role that tight regulatory controls may be playing in the "credit crunch," and liberalization of the SBA's 7(a) Guaranteed Loan Program.

The relatively small role played by the equity markets in small business formation and expansion is due in large part to the inherently risky nature of such enter-

[13] *See,* "Fears Mount That Small-Business Sector is in a State of Permanent Retrenchment," *Wall Street Journal,* February 14, 1992, p. B2.

[14] Gallup Organization, Inc., *Small Business Outlook and Attitudes,* National Small Business United (NSBU), 1991, pages 4 and 9.

[15] The relatively low ranking of "access to capital" as a problem for small businesses is consistent with the findings of other earlier surveys conducted by small business organizations. Findings contained in *Small Business Problems and Priorities,* released in 1986 by the Institute for Enterprise Advancement (an affiliate of the National Federation of Independent Business), revealed that as a measure of problems facing small businesses, obtaining long-term business loans, obtaining short-term business loans, and obtaining investor (equity) financing, ranked 44, 54 and 61, respectively. Not surprisingly, leading the list of problem areas were issues such as cost of health insurance, cost and availability of liability insurance and federal taxes on business income.

prises. It is estimated that more than half of all new businesses fail in the first year, and only about one out of every 30 ever qualify as long-term success stories.[16] Venture capitalists often shun start-up businesses because they do not meet their growth criteria or because the founders of the companies are unwilling to relinquish control to outsiders. Nonetheless, access to the equities' markets is an important issue for some small businesses. Until the late 1980s, such firms faced considerable red tape under federal programs or, if a liberal state level rule or exemption was available to them, the lack of a multi-state marketplace for the selling of new issues. It was against this backdrop that state securities agencies took action beginning in 1988 to, in the words of one account, "cut the Gordian knot of minimizing risk in small-business securities while building a bridge between investor capital and cash-hungry enterprises."[17]

Conclusion

Mr. Chairman, Senator D'Amato, and Members of the Subcommittee, NASAA appreciates the opportunity to appear here to discuss an issue that state securities regulators know quite a bit about—facilitating small business capital formation. But, state securities regulators also understand perhaps better than anyone else the delicate balance that must be arrived at between investor protection and capital formation. NASAA and its members hope to work closely with this Subcommittee as you move forward on these small business initiatives. Thank you.

WRITTEN STATEMENT OF MATTHEW P. FINK

PRESIDENT, INVESTMENT COMPANY INSTITUTE

MARCH 4, 1993

I. Introduction

The Investment Company Institute[1] appreciates the opportunity to present its views on S.479, the "Small Business Incentive Act of 1993." We strongly support the basic objective of this bill, which is to promote capital formation for small businesses. Small businesses play a vital role in our economy, and we support efforts to address the problems they face in gaining access to adequate financing. In this regard, we note that investment companies, as intermediaries, serve as a significant source of capital for small businesses, and that more and more funds have been organized to invest primarily in securities issued by smaller companies. For example, as of December 1992, there were at least 57 small company growth mutual funds, with aggregate assets of over $19 billion.

We have supported steps the SEC has taken during the past year to increase further the ability of investment companies to provide capital to small businesses. For example, last March, precisely for this purpose, the SEC increased the amount of illiquid securities that mutual funds (other than money market funds) may hold. Specifically, the limit was raised from 10 percent of a fund's net assets to 15 percent of net assets.[2]

In addition, the SEC has proposed rules and rule changes to allow the creation of new types of investment companies that would be permitted to offer shares that are redeemable on a periodic basis less frequent than daily. These "interval funds" would be able to invest in securities that are less liquid than those purchased by traditional mutual funds, such as securities issued by small businesses, because they would not be required to meet daily redemption requests. The Institute generally supports the SEC's proposals to establish these new types of funds.

Our specific comments on the proposed legislation are set forth below.

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[16] Small Business Capital Formation Committee, *Small Business Capital Formation Report*, North American Securities Administrators Association, January 1992, page 6.

[17] Terence M. Finan, "Small Business Stocks Get a Boost," United Press International (Seattle), November 6, 1989 (via Newsnet database).

[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 4,006, open-end investment companies ("mutual funds"), 325 closed-end investment companies and 13 sponsors of unit investment trusts. Its mutual fund members have assets of about $1.618 trillion, accounting for approximately 95 percent of total industry assets, and have over 38 million individual shareholders.

[2] We note that one obstacle to this favorable development is presented by certain states which have regulations imposing stricter limits on investments by mutual funds in illiquid securities, and/or limiting investments in "unseasoned" issuers. The Institute has been working with these states and with the North American Securities Administrators Association to try to persuade them to make these regulations consistent with federal law.

II. S. 479, the "Small Business Incentive Act"

S. 479 seeks to accomplish its objective of promoting small business capital formation by reducing regulatory burdens and costs associated with small businesses' gaining access to financing through the securities markets. Specifically, the bill would amend various provisions of the Investment Company Act, so that certain financing vehicles could provide additional capital to smaller businesses without becoming subject to all (or, in certain cases, any) of the Investment Company Act's requirements, and the costs and burdens such requirements can entail.

A. Background: The Investment Company Act of 1940

Investment companies are pools of securities that provide investors with benefits to which they otherwise do not have easy access, such as diversification, economies of scale, and professional management. The Investment Company Act was enacted over 50 years ago because Congress found that investment companies, by their very nature, presented unique investor protection concerns that are not adequately addressed by the disclosure requirements of the Securities Act of 1933 or the continuing reporting and disclosure requirements of the Securities Exchange Act of 1934.[3]

Thus, Congress passed the Investment Company Act to address, among other things, the need for investors to receive adequate information about the nature of the investment company, the need to protect the physical integrity of the company's assets, the need to guard against self-dealing, the need to restrict unfair and unsound capital structures and the need to assure fair and accurate valuation of the company's securities. Accordingly, the core provisions of the Investment Company Act impose specific, continuing disclosure and reporting requirements, require that investment company assets be maintained by a separate custodian, severely restrict transactions involving persons affiliated with the investment company, impose governance requirements as a check on fund management, prohibit excessive leveraging and require fair and accurate valuation of securities in the company's portfolio.

These provisions remain as important today as they were when the Investment Company Act was first adopted. Moreover, they have proved to be very effective. Thus, in its May 1992 report on investment company regulation, the SEC's Division of Investment Management stated: "Our recommendations leave unchanged the fundamental principles underlying the Investment Company Act. Their soundness is demonstrated by the successful and safe operation of investment companies. Indeed, those principles are partially responsible for the remarkable success of the industry."[4]

The Institute's comments on S. 479 are premised on our view that, because of the inherent potential for abuse that the investment company structure involves and the proven effectiveness of the existing regulatory scheme, any proposal to exempt pooled investment vehicles from the investor protections set forth in the Investment Company Act must be approached with caution. It is against this background that we express our specific concerns with certain provisions of the proposed legislation.

B. Specific Concerns on S. 479

1. THE "QUALIFIED PURCHASER" EXCEPTION

Section 201 of S. 479 would add a new Section 3(c)(7) to the Investment Company Act. That section would except from the definition of investment company any investment pool the securities of which are held exclusively by "qualified purchasers," as defined in Section 202 of the bill. Thus, such exempted securities pools would not be subject to *any* of the core investor protection provisions of the Investment Company Act. Moreover, while the stated purpose of the bill is to help small businesses, there would be no requirements governing the content of these pools' portfolios. Thus, these unregulated pools would not be required to invest in securities issued by small businesses. As further discussed below, the Institute is opposed to the "qualified purchaser" provision of the legislation as currently drafted.

The Institute submits that it is critical that Congress seek to ensure that only those investors who truly are capable of safeguarding their interests be permitted to purchase securities issued by these totally unregulated pools. The approach taken in Section 202 of S. 479, which adds a new Section 2(a)(51) to the Investment Company Act, is flawed because it does not establish an appropriate statutory standard. It instead would delegate to the SEC the authority to define who is a "qualified purchaser," based on various factors including several set forth in the proposed new section.

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[3] Investment Company Act of 1940 and Investment Advisers Act of 1940, S. Rep. No. 1775, 76th Cong., 3d Sess. pp. 9–10 (1940).

[4] Division of Investment Management, Securities and Exchange Commission, *Protecting Investors: A Half Century of Investment Company Regulation* (May 1992) at p. xxii.

The Institute is very concerned that the broad degree of discretion granted to the SEC would allow the SEC to adopt a definition of "qualified purchaser" that would permit the offering of unregulated pools of securities, including pools not investing in small businesses, to hundreds of thousands of investors who cannot fend for themselves. In our view, this result would be wholly inappropriate.

We recommend that a more prudent approach be followed: *Congress* should determine the scope of the proposed exception by defining "qualified purchaser" in the statute. Any standard serving as the basis for a complete exemption from the investor protection provisions of the Investment Company Act should be established by the Congress and not left to agency discretion.

Moreover, with respect to the specific standard chosen, we recommend that a "qualified purchaser" be required, at a minimum, to own and invest on a discretionary basis at least $100 million in securities of issuers that are not affiliated which that person. This minimum standard, which is based on the definition of "qualified institutional buyer" in Rule 144A under the Securities Act of 1933, should result in continuing application of the protections afforded under the Investment Company Act to all but the most highly sophisticated investors. This standard would also mitigate any possible adverse impact that an overly broad definition of "qualified purchaser" could have. For example, if shares of these unregulated investment companies are sold to a significantly large group of investors, any losses resulting from abuses of the type the Investment Company Act is intended to prevent (e.g., abusive affiliated transactions, excessive leveraging or improper valuation of assets) could have a widespread negative impact on investor confidence and on the financial system as a whole.

Finally, we recommend that Congress clarify that financial institutions may not aggregate accounts of small investors for purposes of satisfying the "qualified purchaser" standard, as this clearly would be contrary to the intent of proposed Section 3(c)(7).

2. Business Development Companies

In 1980, Congress enacted the "Small Business Investment Incentive Act of 1980," which amended the Investment Company Act to authorize the creation of "business development companies" ("BDCs"), companies which are not designed to be passive investment pools like traditional mutual funds and other investment companies, but which instead are intended to assist in the financing of small business by directly providing capital and managerial assistance to small firms. The Report of the House Committee on Interstate and Foreign Commerce on H.R. 7554 (which ultimately was adopted as the "Small Business Investment Incentive Act of 1980") stated:

> One of the key characteristics which distinguishes business development companies from other entities that are subject to the [Investment Company] Act is the significant managerial assistance which business development companies make available to their portfolio companies. The Committee understands that business development companies are not operated for the purpose of making passive investments in securities, but rather seek to provide significant guidance and counsel in the management and operations of the companies to which they furnish capital, and to work closely with each portfolio company in establishing the portfolio company's business objectives, policies and corporate strategy.[5]

In discussing the restrictions imposed on BDCs under the provisions adopted in 1980, the Report further states that such restrictions "are designed to assure that companies electing special treatment as business development companies are in fact those that the Bill is intended to aid—companies providing capital and assistance to small developing or financially troubled businesses that are seeking to expand, not passive investors in large, well-established businesses."[6]

Thus, while we believe that certain adjustments to the BDC provisions of the Investment Company Act may be useful, we are concerned about two proposed changes that would have the effect of converting BDCs into passive investment vehicles similar to traditional investment companies, directly contrary to the intent 1980 legislation.

(a) *Purchases in Secondary Market*

First, under Section 208 of S.479, Section 55 of the Investment Company Act would be amended to permit BDCs to purchase the securities of eligible portfolio companies from persons other than the issuer or its affiliated persons. The Institute submits that allowing BDCs to purchase securities in the secondary market could

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[5] Small Business Investment Incentive Act of 1980, H. Rep. No. 96–1341, 96th Cong., 2d Sess., at p. 32.

[6] *Id.* at p. 23.

have the effect of transforming such entities into passive investment pools—in effect, the functional equivalent of "small cap" investment companies—yet exempt from many of the investor protection provisions of the Investment Company Act. The Institute opposes this change, which would weaken investor protection, particularly since it would not further the stated goals of the legislation, in that no additional capital would be provided to the small business issuer.

The Institute does not believe that the current exemptions that BDCs enjoy from various provisions of the Investment Company Act (e.g., those concerning pricing, capital structure, and affiliated transactions, as well as certain specific prospectus disclosure requirements) can be justified from an investor protection standpoint unless the BDC is performing its designated role of providing capital to smaller companies. We note that there are other efforts underway to increase liquidity in the small business securities market that do not raise the same investor protection concerns and which the Institute generally supports. These include, for example, the SEC's interval funds proposal, as discussed above, and S. 384, the "Small Business Loan Securitization and Secondary Market Enhancement Act," which was recently introduced by Senator D'Amato to promote the securitization of, and development of a secondary market in, small business loans.

(b) *Managerial Assistance*

Second, the Institute has concerns about Section 207 of S. 479, which would relax the current requirement under Section 2(a)(48) of the Investment Company Act that BDCs make available to any eligible portfolio company significant managerial assistance. In our view, if BDCs were exempt from this requirement, they would more closely resemble traditional investment companies than venture capital funds and, as the legislative history of the BDC provisions of the Investment Company Act cited above makes clear, the justification for exempting them from many of the Investment Company Act's investor protection provisions would disappear.

III. Conclusion

The Institute generally supports S. 479, but recommends that certain provisions of the bill's provisions be modified to ensure that important investor protections provided under the Investment Company Act will not be unnecessarily weakened.

Specifically, the Institute urges that S. 479 be amended to include a statutory definition of the term "qualified purchaser." In addition, we question the proposals to permit BDCs to purchase securities on the secondary market and to relax the requirement that BDCs make available significant managerial assistance to portfolio companies, because implementation of the proposed changes would bring into question the special treatment afforded to BDCs under the Investment Company Act.

103D CONGRESS
1ST SESSION

S. 384

To increase the availability of credit to small businesses by eliminating impediments to securitization and facilitating the development of a secondary market in small business loans, and for other purposes.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 17 (legislative day, JANUARY 5), 1993

Mr. D'AMATO (for himself, Mr. DODD, Mr. BRYAN, Mr. DOLE, Mr. BOND, Mr. GRAMM, Mr. MACK, Mr. FAIRCLOTH, Mr. BENNETT, Mr. DOMENICI, Mr. SHELBY, Mr. CHAFEE, Mr. NICKLES, Mr. CONRAD, Mr. MURKOWSKI, Mr. STEVENS, Mr. LIEBERMAN, Mr. COHEN. Mr. PRESSLER, Mr. GORTON, Mrs. KASSEBAUM, Mr. DANFORTH, and Mr. JEFFORDS) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To increase the availability of credit to small businesses by eliminating impediments to securitization and facilitating the development of a secondary market in small business loans, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Small Business Loan Securitization and Secondary Market Enhancement Act of 1993".

SEC. 2. SMALL BUSINESS RELATED SECURITY.

(a) DEFINITION.—Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended by adding at the end the following new paragraph:

"(53)(A) The term 'small business related security' means a security that is rated in 1 of the 4 highest rating categories by at least 1 nationally recognized statistical rating organization, and either—

"(i) represents an interest in 1 or more promissory notes evidencing the indebtedness of a small business and originated by an insured depository institution (as defined in section 3 of the Federal Deposit Insurance Act), credit union, insurance company, or similar institution which is supervised and examined by a Federal or State authority; or

"(ii) is secured by an interest in 1 or more promissory notes (with or without recourse to the issuer) and provides for payments of principal in relation to payments, or reasonable projections of payments, on notes meeting the requirements of subparagraph (A).

"(B) For purposes of this paragraph—

"(i) an interest in a promissory note includes ownership rights, certificates of interest or participation in such notes, and rights de-

signed to assure servicing of such notes, or the receipt or timely receipt of amounts payable under such notes; and

"(ii) a small business is a business that meets the criteria for a 'small business concern' established under section 3(a) of the Small Business Act.".

(b) CONFORMING AMENDMENT.—Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended by redesignating paragraph (51) defining the term "foreign financial regulatory authority" as paragraph (52) and inserting such paragraph after paragraph (51), defining the term "penny stocks".

SEC. 3. APPLICABILITY OF MARGIN REQUIREMENTS.

Section 7(g) of the Securities Exchange Act of 1934 (15 U.S.C. 78g(g)) is amended by inserting "or a small business related security" after "mortgage related security".

SEC. 4. BORROWING IN THE COURSE OF BUSINESS.

Section 8(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78h(a)) is amended in the last sentence by inserting "or a small business related security" after "mortgage related security".

SEC. 5. SMALL BUSINESS RELATED SECURITIES AS COLLATERAL.

Clause (ii) of section 11(d)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78k(d)(1)) is amended by inserting "or any small business related security" after "mortgage related security".

SEC. 6. INVESTMENT BY DEPOSITORY INSTITUTIONS.

(a) HOME OWNERS' LOAN ACT AMENDMENT.—Section 5(c)(1) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(1)) is amended by adding at the end the following new subparagraph:

"(S) SMALL BUSINESS RELATED SECURITIES.—Investments in small business related securities (as defined in section 3(a)(53) of the Securities Exchange Act of 1934), subject to such regulations as the Director may prescribe, including regulations concerning the minimum size of the issue (at the time of the initial distribution) or minimum aggregate sales price, or both.".

(b) CREDIT UNIONS.—Section 107(15) of the Federal Credit Union Act (12 U.S.C. 1757(15)) is amended—

(1) in subparagraph (A), by striking "or" at the end;

(2) in subparagraph (B), by inserting "or" at the end; and

(3) by adding at the end the following new subparagraph:

"(C) are small business related securities (as defined in section 3(a)(53) of the Securities Exchange Act of 1934), subject to such regulations as the Board may prescribe, including regulations prescribing the minimum size of the issue (at the time of the initial distribution) or minimum aggregate sales price, or both;".

(c) NATIONAL BANKING ASSOCIATIONS.—Section 5136 of the Revised Statutes (12 U.S.C. 24) is amended in the last sentence in the first full paragraph of paragraph Seventh by striking "or (B) are mortgage" and inserting the following: "(B) are small business related securities (as defined in section 3(a)(53) of the Securities Exchange Act of 1934); or (C) are mortgage".

SEC. 7. PREEMPTION OF STATE LAW.

(a) IN GENERAL.—Section 106(a)(1) of the Secondary Mortgage Market Enhancement Act of 1984 (15 U.S.C. 77r–1(a)(1)) is amended—

(1) by striking "or" at the end of subparagraph (B);

(2) by redesignating subparagraph (C) as subparagraph (D); and

(3) by inserting after subparagraph (B) the following new subparagraph:

"(C) small business related securities (as defined in section 3(a)(53) of the Securities Exchange Act of 1934), or".

(b) OBLIGATIONS OF THE UNITED STATES.—Section 106(a)(2) of the Secondary Mortgage Market Enhancement Act of 1984 (15 U.S.C. 77r–1(a)(2)) is amended—

(1) by striking "or" at the end of subparagraph (B);

(2) by redesignating subparagraph (C) as subparagraph (D); and

(3) by inserting after subparagraph (B) the following new subparagraph:

"(C) small business related securities (as defined in section 3(a)(53) of the Securities Exchange Act of 1934), or".

(c) PREEMPTION OF STATE LAWS.—Section 106(c) of the Secondary Mortgage Market Enhancement Act of 1984 (15 U.S.C. 77r–1(c)) is amended—

(1) in the first sentence, by striking "or that" and inserting ", that";

(2) by inserting ", or that are small business related securities (as defined in section 3(a)(53) of

the Securities Exchange Act of 1934)" before "shall be exempt"; and

(3) by adding at the end the following new subsection:

"(d) IMPLEMENTATION.—

"(1) LIMITATION.—The provisions of subsections (a) and (b) concerning small business related securities shall not apply with respect to a particular person, trust, corporation, partnership, association, business trust, or business entity or class thereof in any State that, prior to the expiration of 7 years after the date of enactment of this Act, enacts a statute that specifically refers to this section and either prohibits or provides for a more limited authority to purchase, hold, or invest in small business related securities by any person, trust, corporation, partnership, association, business trust, or business entity or class thereof than is provided in such amendments. The enactment by any State of any statute of the type described in the preceding sentence shall not affect the validity of any contractual commitment to purchase, hold, or invest that was made prior to such enactment, and shall not require the sale or other disposition of any small busi-

ness related securities acquired prior to the date of such enactment.

"(2) ENACTMENT OF STATE PROVISIONS.—Any State may, not later than 7 years after the date of enactment of this Act, enact a statute that specifically refers to this section and requires registration or qualification of any small business related securities on terms that differ from those applicable to any obligation issued by the United States.".

SEC. 8. INSURED DEPOSITORY INSTITUTION CAPITAL REQUIREMENTS FOR TRANSFERS OF SMALL BUSINESS LOANS AND INVESTMENTS IN SMALL BUSINESS RELATED SECURITIES.

(a) ACCOUNTING PRINCIPLES.—The accounting principles applicable to the transfer of a small business loan with recourse contained in reports or statements required to be filed with the appropriate Federal banking agencies by all insured depository institutions shall be uniform and consistent with generally accepted accounting principles.

(b) CAPITAL REQUIREMENTS.—The amount of capital required to be maintained by an insured depository institution under applicable capital standards and other capital measures with respect to the sale of a small business loan with recourse, as reported under subsection (a), shall not exceed an amount sufficient to meet the institu-

tion's reasonable estimated liability under the recourse arrangement.

(c) INVESTMENTS IN SMALL BUSINESS RELATED SECURITIES.—A small business related security shall be treated as a similarly rated mortgage-backed security under the risk-based capital requirement applicable to insured depository institutions.

(d) REGULATIONS REQUIRED.—Not later than 180 days after the date of enactment of this Act, each appropriate Federal banking agency shall promulgate final regulations implementing this section not later than 180 days after the date of enactment of this Act.

(e) DEFINITIONS.—For purposes of this section—

(1) the term "appropriate Federal banking agency" has the same meaning as in section 3 of the Federal Deposit Insurance Act;

(2) the term "capital standards" has the same meaning as in section 38(c) of the Federal Deposit Insurance Act;

(3) the term "insured depository institution" has the same meaning as in section 3 of the Federal Deposit Insurance Act;

(4) the term "other capital measures" has the same meaning as in section 38(c) of the Federal Deposit Insurance Act;

(5) the term "recourse" shall have the meaning given such term under generally accepted accounting principles;

(6) the term "small business" means a business that meets the criteria for a small business concern established under section 3(a) of the Small Business Act; and

(7) the term "small business related security" has the same meaning as in section 3(a)(53) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(53).

SEC. 9. TRANSACTIONS IN SMALL BUSINESS RELATED SECURITIES BY EMPLOYEE BENEFIT PLANS.

(a) PROHIBITED TRANSACTION EXEMPTION.—The Secretary of Labor, in consultation with the Secretary of the Treasury, shall exempt transactions involving small business related securities (as defined in section 3(a)(53) of the Securities Exchange Act of 1934 (as added by section 2 of this Act)), either unconditionally or on stated terms and conditions, from the restrictions of sections 406 and 407 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1106, 1107) and the taxes imposed under section 4975 of the Internal Revenue Code of 1986 (26 U.S.C. 4975).

(b) CONDITIONS.—In providing for the exemption required under subsection (a) the Secretary of Labor shall consider—

(1) the importance of facilitating transactions in small business related securities; and

(2) the necessity of imposing any term or condition to protect the rights and interests of participants and beneficiaries of such plan.

(c) REGULATIONS.—Not later than 180 days after the date of enactment of this Act, the Secretary of Labor shall promulgate final regulations to carry out subsection (a).

SEC. 10. TAXATION OF SMALL BUSINESS LOAN INVESTMENT CONDUITS.

(a) TAXATION SIMILAR TO REMIC.—The Secretary of the Treasury shall promulgate regulations providing for the taxation of a small business loan investment conduit and the holder of an interest therein similar to the taxation of a real estate mortgage investment conduit and the holder of interests therein under the Internal Revenue Code of 1986.

(b) ADJUSTMENT TO REMIC PROVISIONS.—In promulgating regulations under subsection (a), the Secretary shall make any necessary adjustments to the real estate

mortgage investment conduit provisions to take into consideration—

(1) the purpose of facilitating the securitization of small business loans through the use of small business loan investment conduits and the development of a secondary market in small business loans;

(2) differences in the nature of qualifying mortgages in a real estate mortgage investment conduit and small business loans and obligations; and

(3) differences in the practices of participants in the securitization of real estate mortgages in a real estate mortgage investment conduit and the securitization of other assets.

(c) SMALL BUSINESS LOAN INVESTMENT CONDUIT DEFINED.—For purposes of this section, the term "small business loan investment conduit" means—

(1) any entity substantially all of the assets of which consist of any obligation (including any participation or certificate of beneficial ownership therein) of a business that meets the criteria for a small business concern established under section 3(a) of the Small Business Act; and

(2) if such obligation was originated by an insured depository institution (as defined in section 3 of the Federal Deposit Insurance Act), credit union,

insurance company, or similar institution which is supervised and examined by an appropriate Federal or State authority.

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103D CONGRESS
1ST SESSION

S. 422

To amend the Securities Exchange Act of 1934 to ensure the efficient and fair operation of the government securities market, in order to protect investors and facilitate government borrowing at the lowest possible cost to taxpayers, and to prevent false and misleading statements in connection with offerings of government securities.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 24 (legislative day, JANUARY 5), 1993

Mr. DODD (for himself, Mr. RIEGLE, Mr. D'AMATO, Mr. SHELBY, Mr. KERRY, Mr. PRYOR, and Mrs. MURRAY) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To amend the Securities Exchange Act of 1934 to ensure the efficient and fair operation of the government securities market, in order to protect investors and facilitate government borrowing at the lowest possible cost to taxpayers, and to prevent false and misleading statements in connection with offerings of government securities.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Government Securities Act Amendments of 1993".

SEC. 2. FINDINGS.

The Congress finds that—

(1) the liquid and efficient operation of the government securities market is essential to facilitate government borrowing at the lowest possible cost to taxpayers;

(2) the fair and honest treatment of investors will strengthen the integrity and liquidity of the government securities market;

(3) rules promulgated by the Secretary of the Treasury pursuant to the Government Securities Act of 1986 have worked well to protect investors from unregulated dealers and maintain the efficiency of the government securities market; and

(4) extending the authority of the Secretary and providing new authority will ensure the continued strength of the government securities market.

SEC. 3. EXTENSION OF TREASURY RULEMAKING AUTHORITY.

Section 15C of the Securities Exchange Act of 1934 (15 U.S.C. 78o–5) is amended by striking subsection (g).

SEC. 4. SALES PRACTICE RULEMAKING AUTHORITY.

(a) RULES FOR FINANCIAL INSTITUTIONS.—Section 15C(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–5(b)) is amended—

(1) by redesignating paragraphs (3), (4), (5), and (6) as paragraphs (4), (5), (6), and (7), respectively; and

(2) by inserting after paragraph (2) the following new paragraph:

"(3)(A) With respect to any financial institution that has filed notice as a government securities broker or government securities dealer or that is required to file notice under subsection (a)(1)(B), the appropriate regulatory agency for such government securities broker or government securities dealer may issue such rules and regulations with respect to transactions in government securities as may be necessary to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade, if the Secretary has not determined that the rule or regulation, if implemented would, or as applied does—

"(i) adversely affect the liquidity or efficiency of the market for government securities; or

"(ii) impose any burden on competition not necessary or appropriate in furtherance of the purposes of this section.

"(B) The appropriate regulatory agency shall consult with and consider the views of the Secretary prior to approving or amending a rule or regulation under this para-

graph, except where the appropriate regulatory agency determines that an emergency exists requiring expeditious and summary action and publishes its reasons therefor. If the Secretary comments in writing to the appropriate regulatory agency on a proposed rule or regulation that has been published for comment, the appropriate regulatory agency shall respond in writing to such written comment before approving the proposed rule or regulation.

"(C) In promulgating rules under this section, the appropriate regulatory agency shall consider the sufficiency and appropriateness of then existing laws and rules applicable to government securities brokers, government securities dealers, and persons associated with government securities brokers and government securities dealers.".

(b) RULES BY REGISTERED SECURITIES ASSOCIATIONS.—Section 15A(f)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–3(f)(2)) is amended—

(1) by striking "and" at the end of subparagraph (E); and

(2) by striking the period at the end of subparagraph (F) and inserting ", and (G) with respect to transactions in government securities, to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade.".

(c) OVERSIGHT OF REGISTERED SECURITIES ASSOCIATIONS.—Section 19 of the Securities Exchange Act of 1934 (15 U.S.C. 78s) is amended—

(1) in subsection (b), by adding at the end the following new paragraphs:

"(5) The Commission shall consult with and consider the views of the Secretary of the Treasury prior to approving a proposed rule filed by a registered securities association pursuant to section 15A(f)(2)(G), except where the Commission determines that an emergency exists requiring expeditious or summary action and publishes its reasons therefor. If the Secretary of the Treasury comments in writing to the Commission on a proposed rule that has been published for comment, the Commission shall respond in writing to such written comment before approving the proposed rule. The Commission may approve such a rule if the Secretary of the Treasury has not determined that the rule, if implemented, would, or as applied does—

"(A) adversely affect the liquidity or efficiency of the market for government securities; or

"(B) impose any burden on competition not necessary or appropriate in furtherance of the purposes of this section.

"(6) In approving rules filed by a registered securities association pursuant to section 15A(f)(2)(G), the Commis-

sion shall consider the sufficiency and appropriateness of then existing laws and rules applicable to government securities brokers, government securities dealers, and persons associated with government securities brokers and government securities dealers."; and

(2) in subsection (c), by adding at the end the following new paragraph:

"(5) With respect to rules adopted pursuant to section 15A(f)(2)(G), the Commission shall consult with and consider the views of the Secretary of the Treasury before abrogating, adding to, and deleting from such rules, except where the Commission determines that an emergency exists requiring expeditious or summary action and publishes its reasons therefor.".

SEC. 5. DISCLOSURE BY GOVERNMENT SECURITIES BROKERS AND GOVERNMENT SECURITIES DEALERS WHOSE ACCOUNTS ARE NOT INSURED BY THE SECURITIES INVESTOR PROTECTION CORPORATION.

Section 15C(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–5(a)) is amended—

(1) by redesignating paragraph (4) as paragraph (5); and

(2) by inserting after paragraph (3) the following:

"(4) No government securities broker or government securities dealer that is not a member of the Securities Investor Protection Corporation shall effect any transaction in any security in contravention of such rules as the Commission shall prescribe pursuant to this subsection to assure that its customers receive complete, accurate, and timely disclosure of the inapplicability of Securities Investor Protection Corporation coverage to their accounts.".

SEC. 6. TECHNICAL AMENDMENT.

Section 15C(d)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–5(d)(2)) is amended to read as follows:

"(2) Information received by any appropriate regulatory agency or the Secretary from or with respect to any government securities broker or government securities dealer or with respect to any person associated with a government securities broker or a government securities dealer may be made available by the Secretary or the recipient agency to the Commission, the Secretary, any appropriate regulatory agency, any self-regulatory organization, or any Federal Reserve bank.".

SEC. 7. AMENDMENTS TO DEFINITIONS.

Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended—

(1) in paragraph (34)(G), by amending clauses (ii), (iii), and (iv) to read as follows:

"(ii) the Board of Governors of the Federal Reserve System, in the case of a State member bank of the Federal Reserve System, a foreign bank, an uninsured State branch or State agency of a foreign bank, a commercial lending company owned or controlled by a foreign bank (as such terms are used in the International Banking Act of 1978), or a corporation organized or having an agreement with the Board of Governors of the Federal Reserve System pursuant to section 25 or section 25(a) of the Federal Reserve Act;

"(iii) the Federal Deposit Insurance Corporation, in the case of a bank insured by the Federal Deposit Insurance Corporation (other than a member of the Federal Reserve System or a Federal savings bank) or an insured State branch of a foreign bank (as such terms are used in the International Banking Act of 1978);

"(iv) the Director of the Office of Thrift Supervision, in the case of a savings

association (as defined in section 3(b) of the Federal Deposit Insurance Act) the deposits of which are insured by the Federal Deposit Insurance Corporation;"; and

(2) by amending paragraph (46) to read as follows:

"(46) The term 'financial institution' means—

"(A) a bank (as defined in paragraph (6));

"(B) a foreign bank (as such term is used in the International Banking Act of 1978); and

"(C) a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act) the deposits of which are insured by the Federal Deposit Insurance Corporation.".

SEC. 8. STUDY RELATING TO GOVERNMENT SECURITIES INFORMATION.

(a) IN GENERAL.—The Secretary of the Treasury, the Securities and Exchange Commission, and the Board of Governors of the Federal Reserve System shall monitor and evaluate the effectiveness of private sector efforts to disseminate government securities price and volume information, and determine whether such efforts—

(1) assure the prompt, accurate, reliable, and fair reporting, collection, processing, distribution, and publication of information with respect to quota-

tions for and transactions in government securities and the fairness and usefulness of the form and content of such information;

(2) assure that all government securities information processors may, for purposes of distribution and publication, obtain on fair and reasonable terms such information with respect to quotations for and transactions in government securities as is reported, collected, processed, or prepared for distribution or publication by any processor of such information (including self-regulatory organizations) acting in an exclusive capacity; and

(3) assure that all government securities brokers, government securities dealers, government securities information processors, and other appropriate persons may obtain on terms which are not unreasonably discriminatory such information with respect to quotations for and transactions in government securities as is published or distributed.

(b) REPORT.—A report describing any findings made under this section and any recommendations for legislation shall be submitted to Congress not later than 18 months after the date of enactment of this Act.

SEC. 9. OFFERINGS OF GOVERNMENT SECURITIES.

Section 15(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(c)) is amended by adding at the end the following new paragraph:

"(7) In connection with any bid for or purchase of a government security related to an offering of government securities by or on behalf of an issuer, no government securities broker, government securities dealer, or bidder for or purchaser of securities in such offering shall knowingly or willfully make any false or misleading written statement or omit any fact necessary to make any written statement made not misleading.".

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103D CONGRESS
1ST SESSION

S. 424

To amend the Securities Exchange Act of 1934 with respect to limited partnership rollups.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 24 (legislative day, JANUARY 5), 1993

Mr. DODD (for himself, Mr. RIEGLE, Mr. D'AMATO, Mr. SARBANES, Mr. BOND, Mr. SASSER, Mr. SHELBY, Mr. KERRY, Mr. BRYAN, Mr. DOMENICI, Mrs. BOXER, Mrs. MURRAY, Ms. MIKULSKI, Mr. ROBB, Mr. LEAHY, Mr. INOUYE, Mr. SIMON, Mr. KERREY, Mr. LEVIN, Mr. HOLLINGS, Mr. HARKIN, Mr. AKAKA, Mr. LAUTENBERG, Mr. BRADLEY, Mr. JEFFORDS, Mr. PRYOR, Mr. KOHL, Mr. GRAHAM, Mr. CONRAD, Mr. BOREN, Mr. BINGAMAN, and Mr. WOFFORD) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing and Urban Affairs

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A BILL

To amend the Securities Exchange Act of 1934 with respect to limited partnership rollups.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Limited Partnership Rollup Reform Act of 1993".

SEC. 2. REVISION OF PROXY SOLICITATION RULES WITH RESPECT TO LIMITED PARTNERSHIP ROLLUP TRANSACTIONS.

(a) AMENDMENT.—Section 14 of the Securities and Exchange Act of 1934 (15 U.S.C. 78n) is amended by adding at the end the following new subsection:

"(h) PROXY SOLICITATIONS AND TENDER OFFERS IN CONNECTION WITH LIMITED PARTNERSHIP ROLLUP TRANSACTIONS.—

"(1) PROXY RULES TO CONTAIN SPECIAL PROVISIONS.—It shall be unlawful for any person to solicit any proxy, consent, or authorization concerning a limited partnership rollup transaction, or to make any tender offer in furtherance of a limited partnership rollup transaction, unless such transaction is conducted in accordance with rules prescribed by the Commission under sections 14(a) and 14(d), as required by this subsection. Such rules shall—

"(A) permit any holder of a security that is the subject of the proposed limited partnership rollup transaction to engage in preliminary communications for the purposes of determining whether to solicit proxies, consents, or authorizations in opposition to the proposed transaction, without regard to whether any such communication would otherwise be considered a

solicitation of proxies, and without being required to file soliciting material with the Commission prior to making that determination, except that nothing in this subparagraph shall be construed to limit the application of any provision of this title prohibiting, or reasonably designed to prevent, fraudulent, deceptive, or manipulative acts or practices under this title;

"(B) require the issuer to provide to holders of the securities that are the subject of the transaction such list of the holders of the issuer's securities as the Commission may determine in such form and subject to such terms and conditions as the Commission may specify;

"(C) prohibit compensating any person soliciting proxies, consents, or authorizations directly from security holders concerning such a transaction—

"(i) on the basis of whether the solicited proxies, consents, or authorizations either approve or disapprove the proposed transaction; or

"(ii) contingent on the transaction's approval, disapproval, or completion;

"(D) set forth disclosure requirements for soliciting material distributed in connection with a limited partnership rollup transaction, including requirements for clear, concise, and comprehensible disclosure, with respect to—

"(i) any changes in the business plan, voting rights, form of ownership interest or the general partner's compensation in the proposed limited partnership rollup transaction from each of the original limited partnerships;

"(ii) the conflicts of interest, if any, of the general partner;

"(iii) whether it is expected that there will be a significant difference between the exchange values of the limited partnerships and the trading price of the securities to be issued in the limited partnership rollup transaction;

"(iv) the valuation of the limited partnerships and the method used to determine the value of limited partners' interests to be exchanged for the securities in the limited partnership rollup transaction;

"(v) the differing risks and effects of the transaction for investors in different limited partnerships proposed to be included, and the risks and effects of completing the transaction with less than all limited partnerships;

"(vi) a statement by the general partner as to whether the proposed limited partnership rollup transaction is fair or unfair to investors in each limited partnership, a discussion of the basis for that conclusion, and the general partner's evaluation, and a description, of alternatives to the limited partnership rollup transaction, such as liquidation;

"(vii) any opinion (other than an opinion of counsel), appraisal, or report received by the general partner or sponsor that is prepared by an outside party and that is materially related to the limited partnership rollup transaction and the identity and qualifications of the party who prepared the opinion, appraisal, or report, the method of selection of such party, material past, existing, or contemplated rela-

tionships between the party, or any of its affiliates and the general partner, sponsor, successor, or any other affiliate, compensation arrangements, and the basis for rendering and methods used in developing the opinion, appraisal, or report; and

"(viii) such other matters deemed necessary or appropriate by the Commission;

"(E) provide that any solicitation or offering period with respect to any proxy solicitation, tender offer, or information statement in a limited partnership rollup transaction shall be for not less than the lesser of 60 calendar days or the maximum number of days permitted under applicable State law; and

"(F) contain such other provisions as the Commission determines to be necessary or appropriate for the protection of investors in limited partnership rollup transactions.

The disclosure requirements under subparagraph (D) shall also require that the soliciting material include a clear and concise summary of the limited partnership rollup transaction (including a summary of the matters referred to in clauses (i) through (vii) of that subparagraph) with the risks of the limited

partnership rollup transaction set forth prominently in the fore part thereof.

"(2) EXEMPTIONS.—The Commission may, consistent with the public interest, the protection of investors, and the purposes of this title, exempt by rule or order any security or class of securities, any transaction or class of transactions, or any person or class of persons, in whole or in part, conditionally or unconditionally, from the requirements imposed pursuant to paragraph (1) or, from the definition contained in paragraph (4).

"(3) EFFECT ON COMMISSION AUTHORITY.—Nothing in this subsection limits the authority of the Commission under subsection (a) or (d) or any other provision of this title or precludes the Commission from imposing, under subsection (a) or (d) or any other provision of this title, a remedy or procedure required to be imposed under this subsection.

"(4) DEFINITION.—As used in this subsection the term 'limited partnership rollup transaction' means a transaction involving—

"(A) the combination or reorganization of limited partnerships, directly or indirectly, in which some or all investors in the limited part-

nerships receive new securities or securities in another entity, other than a transaction—

"(i) in which—

"(I) the investors' limited partnership securities are reported under a transaction reporting plan declared effective before January 1, 1991, by the Commission under section 11A; and

"(II) the investors receive new securities or securities in another entity that are reported under a transaction reporting plan declared effective before January 1, 1991, by the Commission under section 11A;

"(ii) involving only issuers that are not required to register or report under section 12 both before and after the transaction;

"(iii) in which the securities to be issued or exchanged are not required to be and are not registered under the Securities Act of 1933;

"(iv) which will result in no significant adverse change to investors in any of

the limited partnerships with respect to voting rights, the term of existence of the entity, management compensation, or investment objectives; or

"(v) where each investor is provided an option to receive or retain a security under substantially the same terms and conditions as the original issue; or

"(B) the reorganization of a single limited partnership in which some or all investors in the limited partnership receive new securities or securities in another entity, and—

"(i) transactions in the security issued are reported under a transaction reporting plan declared effective before January 1, 1991, by the Commission under section 11A;

"(ii) the investors' limited partnership securities are not reported under a transaction reporting plan declared effective before January 1, 1991, by the Commission under section 11A;

"(iii) the issuer is required to register or report under section 12, both before and after the transaction, or the securities to

be issued or exchanged are required to be or are registered under the Securities Act of 1933;

"(iv) there are significant adverse changes to security holders in voting rights, the term of existence of the entity, management compensation, or investment objectives; and

"(v) investors are not provided an option to receive or retain a security under substantially the same terms and conditions as the original issue.

"(5) EXCLUSION.—For purposes of this subsection, a limited partnership rollup transaction does not include a transaction that involves only a limited partnership or partnerships having an operating policy or practice of retaining cash available for distribution and reinvesting proceeds from the sale, financing, or refinancing of assets in accordance with such criteria as the Commission determines appropriate.".

(b) SCHEDULE FOR REGULATIONS.—The Securities and Exchange Commission shall, not later than 12 months after the date of enactment of this Act, conduct rulemaking proceedings and prescribe final regulations under

the Securities Act of 1933 and the Securities Exchange Act of 1934 to implement the requirements of section 14(h) of the Securities Exchange Act of 1934, as amended by subsection (a).

SEC. 3. RULES OF FAIR PRACTICE IN ROLLUP TRANSACTIONS.

(a) REGISTERED SECURITIES ASSOCIATION RULE.—Section 15A(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–3(b)) is amended by adding at the end the following new paragraph:

"(12) The rules of the association to promote just and equitable principles of trade, as required by paragraph (6), include rules to prevent members of the association from participating in any limited partnership rollup transaction (as such term is defined in paragraphs (4) and (5) of section 14(h)) unless such transaction was conducted in accordance with procedures designed to protect the rights of limited partners, including—

"(A) the right of dissenting limited partners to an appraisal and compensation or other rights designed to protect dissenting limited partners;

"(B) the right not to have their voting power unfairly reduced or abridged;

"(C) the right not to bear an unfair portion of the costs of a proposed rollup transaction that is rejected; and

"(D) restrictions on the conversion of contingent interests or fees into non-contingent interests or fees and restrictions on the receipt of a non-contingent equity interest in exchange for fees for services which have not yet been provided.

As used in this paragraph, the term 'dissenting limited partner' means a holder of a beneficial interest in a limited partnership that is the subject of a limited partnership rollup transaction who casts a vote against the transaction and complies with procedures established by the association, except that for purposes of an exchange or tender offer, such term means any person who files an objection in writing under the rules of the association during the period in which the offer is outstanding and complies with such other procedures established by the association.".

(b) LISTING STANDARDS OF NATIONAL SECURITIES EXCHANGES.—Section 6(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(b)) is amended by adding at the end the following:

"(9) The rules of the exchange prohibit the listing of any security issued in a limited partnership rollup transaction (as such term is defined in paragraphs (4) and (5) of section 14(h)), unless such transaction was conducted in accordance with procedures designed to protect the rights of limited partners, including—

"(A) the right of dissenting limited partners to an appraisal and compensation or other rights designed to protect dissenting limited partners;

"(B) the right not to have their voting power unfairly reduced or abridged;

"(C) the right not to bear an unfair portion of the costs of a proposed rollup transaction that is rejected; and

"(D) restrictions on the conversion of contingent interests or fees into non-contingent interests or fees and restrictions on the receipt of a non-contingent equity interest in exchange for fees for services which have not yet been provided.

As used in this paragraph, the term 'dissenting limited partner' means a holder of a beneficial interest in a limited partnership that is the subject of a lim-

ited partnership transaction who casts a vote against the transaction and complies with procedures established by the exchange, except that for purposes of an exchange or tender offer, such term means any person who files an objection in writing under the rules of the exchange during the period in which the offer is outstanding.".

(c) STANDARDS FOR AUTOMATED QUOTATION SYSTEMS.—Section 15A(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-3(b)) is amended by adding at the end the following new paragraph:

"(13) The rules of the association prohibit the authorization for quotation on an automated interdealer quotation system sponsored by the association of any security designated by the Commission as a national market system security resulting from a limited partnership rollup transaction (as such term is defined in paragraphs (4) and (5) of section 14(h)), unless such transaction was conducted in accordance with procedures designed to protect the rights of limited partners, including—

"(A) the right of dissenting limited partners to an appraisal and compensation or other rights designed to protect dissenting limited partners;

"(B) the right not to have their voting power unfairly reduced or abridged;

"(C) the right not to bear an unfair portion of the costs of a proposed rollup transaction that is rejected; and

"(D) restrictions on the conversion of contingent interests or fees into non-contingent interests or fees and restrictions on the receipt of a non-contingent equity interest in exchange for fees for services which have not yet been provided.

As used in this paragraph, the term 'dissenting limited partner' means a holder of a beneficial interest in a limited partnership that is the subject of a limited partnership transaction who casts a vote against the transaction and complies with procedures established by the association, except that for purposes of an exchange or tender offer such term means any person who files an objection in writing under the rules of the association during the period during which the offer is outstanding.".

(d) EFFECT ON EXISTING AUTHORITY.—The amendments made by this section shall not limit the authority of the Securities and Exchange Commission, a registered securities association, or a national securities exchange

under any provision of the Securities Exchange Act of 1934, or preclude the Commission or such association or exchange from imposing, under any other such provision, a remedy or procedure required to be imposed under such amendments.

(e) EFFECTIVE DATE.—The amendments made by this section shall become effective 18 months after the date of enactment of this Act.

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103D CONGRESS
1ST SESSION

S. 479

To amend the Securities Act of 1933 and the Investment Company Act of 1940 to promote capital formation for small businesses and others through exempted offerings under the Securities Act and through investment pools that are excepted or exempted from regulation under the Investment Company Act of 1940 and through business development companies.

IN THE SENATE OF THE UNITED STATES

MARCH 2 (legislative day, JANUARY 5), 1993

Mr. DODD (for himself, Mr. RIEGLE, Mr. D'AMATO, Mr. KERRY, Mr. BRYAN, Mr. MACK, and Mr. DOMENICI) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To amend the Securities Act of 1933 and the Investment Company Act of 1940 to promote capital formation for small businesses and others through exempted offerings under the Securities Act and through investment pools that are excepted or exempted from regulation under the Investment Company Act of 1940 and through business development companies.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Small Business Incentive Act of 1993".

TITLE I—AMENDMENT TO THE SECURITIES ACT OF 1933

SEC. 101. EXEMPTED SECURITIES.

Section 3(b) of the Securities Act of 1933 (15 U.S.C. 77c(b)) is amended by striking "$5,000,000" and inserting "$10,000,000".

TITLE II—AMENDMENTS TO THE INVESTMENT COMPANY ACT OF 1940

SEC. 201. EXCLUSIONS FROM THE DEFINITION OF INVESTMENT COMPANY.

Section 3(c) of the Investment Company Act of 1940 (15 U.S.C. 80a–3(c)) is amended—

(1) In paragraph (1) by adding after the first sentence the following new sentence: "Such issuer shall be deemed to be an investment company for purposes of the limitations set forth in subparagraphs (A)(i) and (B)(i) of section 12(d)(1) governing the purchase or other acquisition by such issuer of any security issued by a registered investment company and the sale of any security issued by a registered open-end investment company to any such issuer.";

(2) In paragraph (1)(A)—

(A) by inserting after "issuer," the first place it appears "and the company is or, but for the exceptions set forth in this paragraph and paragraph (7), would be an investment company,";

(B) by striking "paper) unless as of the date" and all that follows through the end of subparagraph (A) and inserting the following: "paper).";

(3) by amending paragraph (7) to read as follows:

"(7) Any issuer whose outstanding securities are owned exclusively by persons who, at the time of acquisition of such securities, are qualified purchasers, except that such issuer shall be deemed to be an investment company for purposes of the limitations set forth in subparagraphs (A)(i) and (B)(i) of section 12(d)(1) governing the purchase or other acquisition by such issuer of any security issued by a registered investment company and the sale of any security issued by a registered open-end investment company to any such issuer.".

SEC. 202. DEFINITION OF QUALIFIED PURCHASER.

Section 2(a) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)) is amended by adding at the end the following new paragraph:

"(51) 'Qualified purchaser' means any person whom the Commission, by rule or regulation, has determined does not need the protections of this title. The Commission's determination shall include consideration of a person's—

"(A) financial sophistication;

"(B) net worth;

"(C) knowledge of and experience in financial matters;

"(D) amount of assets owned or under management;

"(E) relationship with an issuer; or

"(F) such other factors as the Commission may determine to be consistent with the purposes of this paragraph.".

SEC. 203. DEFINITION OF INVESTMENT SECURITIES.

Section 3(a) of the Investment Company Act of 1940 (15 U.S.C. 80a–3(a)) is amended in the last sentence by striking subparagraph (C) and inserting the following: "(C) securities issued by any majority-owned subsidiary of the owner, unless such subsidiary is an investment company or is excluded from the definition of an investment

company solely by virtue of paragraph (1) or (7) of section 3(c).".

SEC. 204. EXEMPTION FOR BUSINESS AND INDUSTRIAL DEVELOPMENT COMPANIES.

Section 6(a) of the Investment Company Act of 1940 (15 U.S.C. 80a–6(a)) is amended by adding at the end the following new paragraph:

"(5)(A) Any company that is not engaged in the business of issuing redeemable securities, the operations of which are subject to regulation by the State in which it is organized under a statute governing entities that provide financial or managerial assistance to enterprises doing business, or proposing to do business, primarily in that State if—

"(i) the organizational documents of such company state that the purpose of the company is limited to providing financial or managerial assistance to enterprises doing business, or proposing to do business, primarily in that State;

"(ii) immediately following each sale of the securities of such company by the company or any underwriter for the company, not less than 80 percent of the company's securities being offered in such sale, on a class-by-class basis, are

held by persons who reside or have a substantial business presence in that State;

"(iii) the securities of such company are sold, or proposed to be sold, by the company or any underwriter for the company, solely to accredited investors, as defined in section 2(15) of the Securities Act of 1933, or to such other persons that the Commission, as necessary or appropriate in the public interest and consistent with the protection of investors, may permit by rule, regulation, or order; and

"(iv) the company does not purchase any security issued by an investment company, as defined in section 3, or by any company that would be an investment company except for the exclusions from the definition of investment company in section 3(c), other than—

"(I) any security that is rated investment grade by at least 1 nationally recognized statistical rating organization; or

"(II) any security issued by a registered open-end investment company that is required by its investment policies to invest at least 65 percent of its total assets in securities described in subclause (I) or

securities that are determined by such registered open-end investment company to be comparable in quality to securities described in subclause (I).

"(B) Notwithstanding the exemption provided in this paragraph, the provisions of section 9 (and, to the extent necessary to enforce such provisions, sections 38 through 51) of this title shall apply to a company described in this paragraph as if the company were an investment company registered under this title.

"(C) Any company proposing to rely on the exemption provided in this paragraph shall file with the Commission a notification stating that it intends to do so, in such form and manner as the Commission may by rule prescribe.

"(D) Any company meeting the requirements of this paragraph may rely on the exemption provided herein immediately upon filing with the Commission the notification required by subparagraph (C), unless the Commission determines by order that such company's reliance is not in the public interest or consistent with the protection of investors.

"(E) The exemption provided pursuant to this paragraph may be subject to such additional terms

and conditions as the Commission may by rule, regulation, or order determine are necessary or appropriate in the public interest or for the protection of investors.".

SEC. 205. INTRA-STATE CLOSED-END INVESTMENT COMPANY EXEMPTION.

Section 6(d)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a–6(d)(1)) is amended by striking "$100,000" and inserting "$10,000,000, or such other amount as the Commission may set by rule, regulation, or order".

SEC. 206. DEFINITION OF ELIGIBLE PORTFOLIO COMPANY.

Section 2(a)(46)(C) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(46)(C)) is amended—

(1) in clause (ii), by striking "or" at the end;

(2) by redesignating clause (iii) as clause (iv); and

(3) by inserting after clause (ii) the following:

"(iii) it has total assets of not more than $4,000,000, and capital and surplus (shareholders equity less retained earnings) in excess of $2,000,000, except that the Commission may adjust such amounts by rule, regulation, or order to reflect changes

in 1 or more generally accepted indices or other indicators for small businesses; or".

SEC. 207. DEFINITION OF BUSINESS DEVELOPMENT COMPANY.

Section 2(a)(48)(B) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(48)(B)) is amended by inserting before the semicolon at the end the following: ": *And provided further,* That a business development company need not make available significant managerial assistance with respect to any company described in section 55(a)(7) or with respect to any other company that meets such criteria as the Commission may by rule, regulation, or order permit, as consistent with the public interest, the protection of investors, and the purposes fairly intended by the policy and provisions of this title".

SEC. 208. ACQUISITION OF ASSETS BY BUSINESS DEVELOPMENT COMPANIES.

Section 55(a) of the Investment Company Act of 1940 (15 U.S.C. 80a–54(a)) is amended—

(1) by striking "(7)" the first 2 times such figure appears and inserting "(8)";

(2) by striking "(6)" the first time such figure appears and inserting "(7)";

(3) in subparagraph (1)(A)—

(A) by striking ", or from any person" and inserting ", from any person"; and

(B) by inserting before the semicolon ", or from any other person, subject to such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors";

(4) in paragraph (6), by striking "and" at the end;

(5) by redesignating paragraph (7) as paragraph (8); and

(6) by inserting after paragraph (6) the following new paragraph:

"(7) securities of any eligible portfolio company with respect to which the business development company satisfies the requirements of section 2(a)(46)(C)(iii); and".

SEC. 209. CAPITAL STRUCTURE AMENDMENTS.

Section 61(a) of the Investment Company Act of 1940 (15 U.S.C. 80a–60(a)) is amended—

(1) by striking paragraph (1) and inserting the following:

"(1)(A) The asset coverage requirements of subparagraphs (A) and (B) of section 18(a)(1) ap-

plicable to business development companies shall be 200 percent.

"(B) Notwithstanding subsection (a)(1)(A) of this section and subparagraphs (A) and (B) of section 18(a)(2), a business development company may have an asset coverage of at least 110 percent, if, immediately before the issuance or sale of senior securities, it has—

"(i) total interest and dividend income for the 12 months preceding such issuance or sale that exceeds 120 percent of the sum of its total expenses (including taxes and interest expenses accrued) and dividends declared on senior securities for that 12-month period; and

"(ii) either—

"(I) an average of not less than 50 percent of its assets invested in securities described in paragraphs (1) through (5) of section 55(a) throughout the preceding 12-month period; or

"(II) not less than 50 percent of its assets invested in securities described in paragraphs (1) through (5) of section 55(a) throughout 10 months of the preceding 12-month period.

"(C) It shall be unlawful for any business development company to issue any class of senior security representing indebtedness, or to sell any such security pursuant to subsection (a)(1)(B) of this section, unless provision is made to prohibit the declaration of any dividend (except a dividend payable in stock of the issuer), or the declaration of any other distribution upon any class of the capital stock of such business development company, or the purchase of any such capital stock, unless, in every such case—

"(i) such class of senior securities has, at the time of the declaration of any such dividend or distribution or at the time of any such purchase, an asset coverage of not less than 110 percent after deducting the amount of such dividend, distribution, or purchase price as the case may be; and

"(ii) the business development company complies with subparagraph (B)(i) except with respect to any amounts that are required to be distributed to maintain the company's status as a regulated investment company under the Internal Revenue Code of 1986.

"(D) It shall be unlawful for any business development company to issue any class of senior secu-

rity representing stock, or to sell any such security pursuant to subsection (a)(1)(B) of this section, unless provision is made to prohibit the declaration of any dividend (except a dividend payable in common stock of the issuer), or the declaration of any other distribution, upon the common stock of such business development company, or the purchase of any such common stock, unless, in every such case—

"(i) such class of senior securities has, at the time of the declaration of any such dividend or distribution or at the time of any such purchase an asset coverage of not less than 110 percent after deducting the amount of such dividend, distribution or purchase price; and

"(ii) the business development company complies with subparagraph (B)(i), except with respect to any amounts that are required to be distributed to maintain the company's status as a regulated investment company under the Internal Revenue Code of 1986.";

(2) in paragraph (2), by striking "if such business development company" and all that follows through the end of paragraph (2) and inserting a period; and

(3) in paragraph (3)(A)—

(A) by striking "senior securities representing indebtedness accompanied by";

(B) inserting "either alone or accompanied by securities," after "of such company,"; and

(C) in clause (ii), by striking "senior".

SEC. 210. FILING OF WRITTEN STATEMENTS.

Section 64(b)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a–63(b)(1)) is amended by inserting "and capital structure" after "portfolio".

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